LIBRARY
SUPREME COURT, U.S.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1951

No. 173

JOSEPH T. LYKES, PETITIONER,

vs.

THE UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 5, 1951.

CERTIORARI GRANTED OCTOBER 8, 1951.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 173

JOSEPH T. LYKES, PETITIONER,

vs.

THE UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

INDEX

	Original	Print
Proceedings in U.S.C.A., Fifth Circuit	1	1
Caption (omitted in printing)	1	
Record from U.S.D.C., Southern Florida	2	1
Complaint	2	1
Exhibit A—Comparative Tax Calculations, 1944	6	4
Exhibit B—Claim for refund	7	4
Exhibit C—Notice of disallowance	14	7
Answer	15	7
Proceedings on final hearing	18	9
Colloquy	18	10
Stipulation	19	10
Testimony of Edward G. Netscher	22	12
Testimony of Joseph T. Lykes	25	14
Reporter's certificate (omitted in printing)	43	
Memorandum decision, Devane, J.	44	26
Judgment	50	31
Notice of appeal	51	32
Amended notice of appeal	51	32
Motion for extension of time to file record and order granting same (omitted in printing)	52	
Stipulation of record (omitted in printing)	53	
Motion for transmittal of original exhibits and order thereon (omitted in printing)	54	
Clerk's certificate (omitted in printing)	57	
Opinion, Strum, J.	58	33
Judgment	63	38
Clerk's certificate	64	39
Order granting certiorari	65	40

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., OCT. 22, 1951.

—7875

[fol. 1] [Caption omitted]

[fol. 2]

IN THE UNITED STATES DISTRICT COURT IN AND FOR THE SOUTHERN DISTRICT OF FLORIDA, TAMPA DIVISION

No. 1556-Civ-T

JOSEPH T. LYKES, Plaintiff,

vs.

UNITED STATES OF AMERICA, Defendant

COMPLAINT

The plaintiff, Joseph T. Lykes, by his undersigned attorney presents this his complaint against the United States of America pursuant to the provisions of Section 24(20) of the Judicial Code as amended (28 USCA 41(20)) and alleges as follows:

1. The plaintiff, Joseph T. Lykes, resides at 1040 El Dorado, City of Clearwater, in the County of Pinellas, State of Florida.

2. This is a suit for the recovery of federal income taxes overpaid by the plaintiff for the calendar year 1944 in the amount of $5,645.78, plus interest.

3. Taxpayer filed on January 13, 1945, an income tax return on Form 1040 for the taxpayer's taxable year 1944, that being the calendar year 1944, that return showing a tax payable in the amount of $34,782.91, which amount the taxpayer paid in the following manner:

[fol. 3]

By payments on 1944 Declaration of Estimated Tax	$ 1,929.42
By payroll deductions	4,554.40
By payment Jan. 13, 1945	28,299.09
	$34,782.91

All payments thereupon being made by or before January 13, 1945.

4. That return of the taxpayer failed to include as a deduction an amount of $7,263.83, which was paid on August

30, 1944, to Kenneth I. McKay, attorney at law, Tampa, Florida, for legal services and advice in connection with contested deficiencies assessed by the Commissioner of Internal Revenue on gifts made by the taxpayer and included in the taxpayer's gift tax return for the year 1940.

5. The exclusion of the foregoing deduction was inadvertent, and the taxpayer contended and contends that it is a proper deduction under the provisions of the Internal Revenue Code, Section 23(a)(2). The gifts made were of shares of stock in a corporation in which the taxpayer was a principal stockholder. They represented a part of the shares which he held in that corporation, which holdings were his major investment. He had himself spent his life in the service of that corporation. It was a part of the purpose of the gift to obtain, by parting with such shares, an interest in the operation of the business among, generally, younger members of the taxpayer's family so as to increase or maintain the potential value of the remaining shares held by the taxpayer and the income which they would produce. Further, the dispute concerning the gift tax consisted of a disagreement between the government and the taxpayer about the value of the shares given; and conse-
[fol. 4] quently, the decision affected the value of the shares retained and the ability of the taxpayer to proceed further in his plan of giving; and further, it affected his ability to protect that property against unjust intangible personal property taxes which might be assessed by the State of Florida or other states; and, moreover, involved other problems faced by the taxpayer concerning the conservation and maintenance of his remaining property because of the unfair valuations for which the Commissioner of Internal Revenue was contending in that gift tax controversy. Further, the claim of the government under which it threatened to file a deficiency assessment was so obviously exorbitant and ill-founded that the deficiency determined by the Commissioner to aggregate $145,276.50 was settled under stipulation before the Tax Court of the United States, without trial, for the amount of $15,612.75; and it is therefore apparent that if the taxpayer's interests had not been protected by proceedings in the Tax Court, taxpayer would have had to pay a considerable tax which was not due. In order

to pay such a tax, taxpayer would have had to dispose of property which he held for the production of income, which property, if disposed of by the taxpayer, could not have been conveniently replaced with property of like value.

6. The deduction of $7,263.83 increases the taxpayer's allowable deductions for the taxable year 1944 from $4,452.26 to $11,716.09; and, as shown by the comparative tax calculations of Exhibit A attached, this reduces the income tax for the year 1944 from the amount paid of $34,782.91 to an amount of $29,117.13, showing an overpayment of the income tax for that year of $5,665.78, which amount it is claimed by the taxpayer should be refunded.

7. The taxpayer executed and filed a claim for refund with the Collector of Internal Revenue at the Custom House [fol. 5] in New York City, New York 4, N. Y., on the 9th day of March, 1946, which claim was received by the Collector of Internal Revenue on or about that day.

8. There was forwarded to the taxpayer by registered mail under date of February 16, 1948, a notice of disallowance in full of the claim filed, given by the direction of the Commissioner, by E. J. McLarney, Deputy Commissioner.

9. A true copy of the claim for refund is attached as Exhibit B, and a copy of the notice of disallowance given by registered mail is attached as Exhibit C.

Wherefore, the Plaintiff prays that judgment may be entered herein in favor of the plaintiff and against the defendant for $5,665.78, plus interest at 6% per annum, together with costs of suit, and for such other and further relief as to this Court may seem meet.

Chester H. Ferguson, George W. Ericksen, Attorneys for Plaintiff, Address: 215 Madison Street, (P.O. Box 1531), Tampa, Florida.

Of Counsel: MacFarlane, Ferguson, Allison & Kelly.

[fol. 6] EXHIBIT "A"

1944

COMPARATIVE TAX CALCULATIONS

	Tax Calculation on Taxpayer's return	Tax Calculation on Corrected Income after deduction of $5,665.78 not included in return
Adjusted gross income	$63,238.05	$63,238.05
Less: Deductions	4,452.26	11,716.09
Net income	58,785.79	51,521.96
Surtax exemptions	500.00	500.00
Taxable net income—surtax	58,285.79	51,021.96
Surtax	33,034.34	27,586.47
Normal Tax		
Net income	58,785.79	51,521.96
Normal tax Exemption	500.00	500.00
Taxable Net Income—Normal Tax	58,285.79	51,021.96
Normal Tax	1,748.57	1,530.66
Total Tax	34,782.91	29,117.13

Overpayment: $34,782.91 less $29,117.13, or $5,665.78

(Here follow 3 Photolithographs, side folios 7, 8, 9-10)

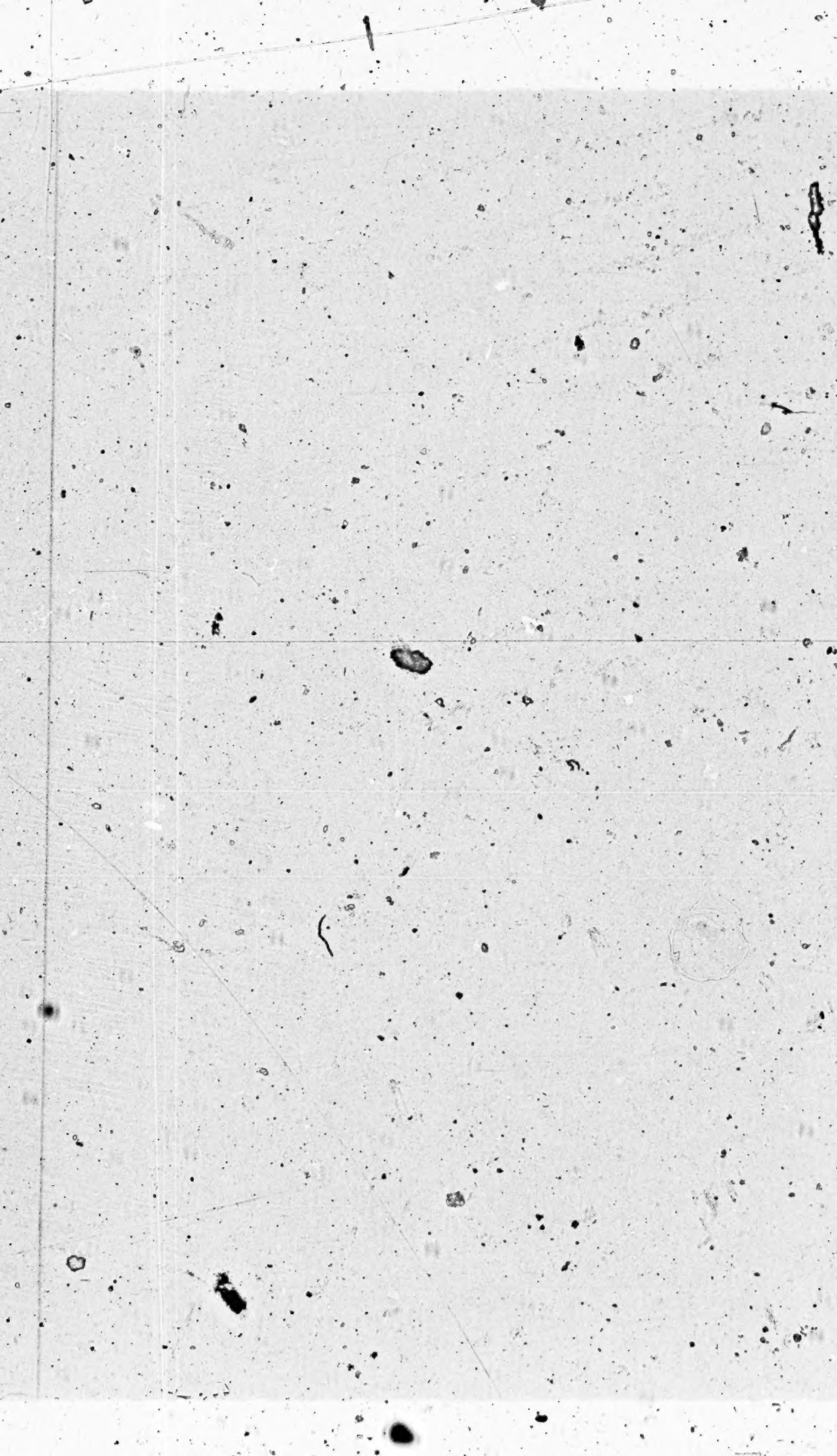


EXHIBIT "B"

Form 843
TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
(Revised Oct. 1945)

CLAIM

TO BE FILED WITH THE COLLECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

COLLECTOR'S STAMP
(Date received)

[X] REFUND OF TAXES ILLEGALLY ~~ERRONEOUSLY, OR EXCESSIVELY~~ COLLECTED.

[ ] REFUND OF AMOUNT PAID FOR STAMPS UNUSED, OR USED IN ERROR OR EXCESS.

[ ] ABATEMENT OF TAX ASSESSED (not applicable to estate, gift, or income taxes).

STATE OF New York }
COUNTY OF New York } ss:

TYPE OR PRINT

Name of taxpayer or purchaser of stamps JOSEPH T. LYKES

Business address 17 Battery Place (Street) New York (City or town, postal zone number) New York (State)

Residence 631 Esplanade, Pelham Manor, New York

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed 2nd Dist. Int. Rev. House, New York City
2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1944, to Dec. 31, 1944
3. Character of assessment or tax Income Tax
4. Amount of assessment, $ 34,782.91; dates of payment see statement attached
5. Date stamps were purchased from the Government
6. Amount to be refunded $ 5,665.78
7. Amount to be abated (not applicable to income, gift, or estate taxes) $
8. The time within which this claim may be legally filed expires, under section 322 (b) of Revenue Act of 1938 (Revenue Act or Internal Revenue Code) on March 15, 1948

The deponent verily believes that this claim should be allowed for the following reasons:

In preparing his income tax return for the year 1944, taxpayer inadvertently omitted to include as a deduction on the return the amount of

EXHIBIT "B"

4B

File this return with Collector of Internal Revenue on or before March 15, 1945. Any balance of tax due (item 8, below) must be paid in full with return. See separate Instructions for filling out return.

Page 1

FORM 1040
Treasury Department
Internal Revenue Service

U. S. INDIVIDUAL INCOME TAX RETURN
FOR CALENDAR YEAR 1944

1944

or fiscal year beginning _____, 1944, and ending _____, 1945

Do not write in these spaces

File Code

Serial No.

District

(Cashier's Stamp)

EMPLOYEES.—Instead of this form, you may use your Withholding Receipt, Form W-2 (Rev.), as your return, if your total income was less than $5,000, consisting wholly of wages shown on Withholding Receipts or of such wages and not more than $100 of other wages, dividends, and interest.

NAME JOSEPH T. LYKES
(PLEASE PRINT. If this return is for a husband and wife, use both first names)

ADDRESS 631 Esplanade
(PLEASE PRINT. Street and number or rural route)

Pelham Manor, N. Y.
(City or town, postal zone number) (State)

Social Security No. (if any) 060-10-4389

Your Exemptions

1. List your own name. If married and your wife (or husband) had no income, or if this is a joint return of husband and wife, list name of your wife (or husband). List names of other close relatives with 1944 incomes of less than $500 who received more than one-half of their support from you. If this is a joint return of husband and wife, list dependent relatives of both.

NAME (Please print)	Relationship	NAME (Please print)	Relationship
Your name	x x x x x x x x x		

Your Income

2. Enter your total wages, salaries, bonuses, commissions, and other compensation received in 1944, BEFORE PAY-ROLL DEDUCTIONS for taxes, dues, insurance, bonds, etc. Members of armed forces and persons claiming traveling or reimbursed expenses, see Instruction 2.

PRINT EMPLOYER'S NAME	WHERE EMPLOYED (CITY AND STATE)	AMOUNT	
Lykes Bros. Co., Inc.	New York City, N.Y.	$ 24,000	00

Enter total here → $ 24,000 00

Do not use this page if r income is wholly from salaries, wages, div ds, and interest

Schedule A.—INCOME FROM ANNUITIES OR PENSIONS

1. Cost of annuity (total amount you paid in)	$	4. Total amount received this year	$
2. Amount received tax-free in prior years		5. Excess, if any, of line 4 over line 3	
3. Remainder of your cost (line 1 less line 2)	$	6. Enter line 5, or 3 percent of line 1, whichever is greater	$

Schedule B.—INCOME FROM RENTS AND ROYALTIES

1. Kind of property	2. Amount of rent or royalty	3. Depreciation or depletion (explain in Schedule F)	4. Repairs (explain in Schedule G)	5. Other expenses (itemize in Schedule G)
	$	$	$	$
Net profit (or loss) (col. 2 less sum of cols. 3, 4, and 5)	$	$	$	$

Schedule C.—PROFIT (OR LOSS) FROM BUSINESS OR PROFESSION. (Farmers should obtain Form 1040F)

(State (1) nature of business _____; (2) business name _____)

1. Total receipts _____ $

COST OF GOODS SOLD

(To be used where inventories are an income-determining factor)

(Enter the letters "C," or "C or M," on line 2 and 8 if inventories are valued at either cost, or cost or market whichever is lower)

2. Inventory at beginning of year	$	
3. Merchandise bought for sale		
4. Labor		
5. Material and supplies		
6. Other costs (explain in Schedule G)		
7. Total of lines 2 to 6	$	
8. Less inventory at end of year		
9. Net cost of goods sold (line 7 less line 8)	$	
10. Gross profit (line 1 less line 9)	$	

OTHER BUSINESS DEDUCTIONS

11. Salaries and wages not included as "Labor"	$	
12. Interest on business indebtedness		
13. Taxes on business and business property		
14. Losses (explain in Schedule G)		
15. Bad debts arising from sales or services		
16. Depreciation, obsolescence and depletion (explain in Schedule F)		
17. Rent, repairs, and other expenses (explain in Schedule G)		
18. Amortization of emergency facilities (attach statement)		
19. Net operating loss deduction (attach statement)		
20. Total of lines 11 to 19	$	
21. Total of lines 9 and 20	$	
22. Net profit (or loss) (line 1 less line 21)		

Schedule D.—GAINS AND LOSSES FROM SALES OR EXCHANGES OF CAPITAL ASSETS, ETC.

Do not itemize deductions if—(1) You determine your tax from the tax table on page 2, or
(2) Your total income is $5,000 or more and you claim the $500 standard deduction.
If husband and wife living together at end of year file separate returns and one itemizes deductions, the other must file his or her return on Form 1040, and must also itemize deductions.

Page 4

DEDUCTIONS

Describe deductions and state to whom paid. If more space is needed, list deductions on separate sheet of paper and attach to this return.

			Amount	
Contributions				
	See Attached List	736 50		
	Allowable Contributions (not in excess of 15 percent of item 5, page 1)		$ 736	50
Interest				
	Total Interest			
Taxes	Stock Transfer Stamps	$ 3 70		
	License Plates	39 00		
	N. Y. State Income Tax	3,006 11		
	Real Estate - Lots in Tampa	50 37		
	N.Y.C. Sales(est.) 30.Gasoline Tax			
	Total Taxes (Est.) 12.50	42 50	3,141	68
Losses from fire, storm, shipwreck, or other casualty, or theft				
	Total Allowable Losses (not compensated by insurance or otherwise)			
Medical and dental expenses				
	Net Expenses (not compensated by insurance or otherwise)			
	Enter 5 percent of item 5, page 1, and subtract from Net Expenses			
	Allowable Medical and Dental Expenses. See Instruction for limitation			
Miscellaneous	Solicitation Exp. directly relating			

expenses

[fol. 11] JOSEPH T. LYKES

Statement attached to and made part of claim for refund of income tax overpaid for the year 1944, form 843

The taxpayer filed, on Jan. 13, 1945, form 1040 for the taxable year 1944 and paid the full amount of the tax shown thereon as follows:

By payments on 1944 Declaration of Estimated Tax	$ 1,929.42
By payroll deductions	4,554.40
By payment Jan. 13, 1945	28,299.09
	$34,782.91

In preparing said return, the taxpayer inadvertently failed to include therein as a deduction under the provisions of Section 23(a)(2) of the Internal Revenue Code as amended the sum of $7,263.83 paid on Aug. 30, 1944 to Kenneth I. McKay, attorney at law, Tampa, Florida, for legal services and advice in connection with contesting deficiencies assessed by the Commissioner of Internal Revenue on gifts made by the taxpayer and included in his gift tax return for the year 1940.

Tax shown on Income Tax return for the year 1944 and paid as above scheduled	$34,782.91
Tax shown on amended 1944 Income Tax return attached hereto	29,117.13
Amount of overpayment of Income tax for the year 1944 to be refunded	$ 5,665.78

[fol. 12] The taxpayer believes that the case of Howard E. Cammack vs. Commissioner of Internal Revenue and Edward Arthur Cammack vs. Commissioner of Internal Revenue 5 T.C. 467, which held that legal fees paid were deductible under section 23(a)(2) I.R.C., is directly in point and is identical with facts existing in the instant case. For Commissioner's acquiescence, see Internal Revenue Bulletin, September 25, 1945, No. 18. To the same end, see

Louis E. Stodard, Jr., vs. Commissioner, C.C.A. 2, December 3, 1945. Both cases cite the decision of the U. S. Supreme Court in the case Trust u/w of Mary Lily (Flagler) Bingham, Messrs. William R. Kenan, Jr. and Lawrence C. Haines, Petitioners vs. Commissioner of Internal Revenue.

Signed, —— ——, Taxpayer.

Sworn to and subscribed before me this 9th day of March, 1946. —— ——.

[fol. 13] Copy

SALE OF 501 MANOR LANE HOUSE SEPT. 26, 1942 FRAME DWELLING HOUSE, PELHAM MANOR, N. Y.

Bought in 1919—Cost of building $18,000.00—Cost of Lane, $3,000.00—Total $21,000.00		
(Appraised by Internal Revenue Dept. 1932)		$21,000.00
Less: Depreciation 3% of $18,000.00 for 10 years	$5400.00	
1/1 to 9/26/22—269/365th of $540.00	397.00	5,797.97
Adjusted basis		15,202.03
Selling price—Less Expense of Sale		7,571.60
Corrected loss on sale of capital assets		7,630.43
Loss to be taken into account (50% of $7,630.43)		3,815.21
Loss allowed in 1942 tax report		1,000.00
Loss allowed in 1943 tax report		1,000.00
Loss allowed in this, 1944 tax report		1,000.00

Note: The above form and figures copied from Internal Revenue Auditors audit of the 1943 tax return, see letter from 225 Broadway, Aug. 14, 1944, signed by C. A. Krigbaum, Auditor in charge.

[fol. 14] EXHIBIT "C" TO COMPLAINT

Treasury Department
Washington 25

Feb. 16, 1948

Joseph T. Lykes, 631 Esplanade, Pelham Manor, N. Y.

Dear Mr. Lykes:

In re: Claim for refund of $5,655.78 for the year 1944.

In accordance with the provisions of section 3772(a)(2) of the Internal Revenue Code, this notice of disallowance in full of your claim or claims is hereby given by registered mail.

By direction of the Commissioner:

Yours very truly, (S.) E. J. McLarney, Deputy Commissioner

cc EGN CHF

[fol. 15] IN UNITED STATES DISTRICT COURT

On the 8th day of October, 1948, was filed Defendant's Answer in the following words and figures to-wit:

ANSWER—Filed October 8, 1948

The defendant answers the complaint herein, as follows:

I

The allegations in paragraph 1 are admitted.

II

The allegations in paragraph 2 are admitted, except that it is denied that the federal income taxes, for the recovery of which this suit is brought, were overpaid.

III

The allegations in paragraph 3 are denied, but it is admitted that on January 27, 1945, the plaintiff filed an income tax return for the taxable year 1944 in which he re-

ported a tax of $34,782.91; that on January 27, 1945, the plaintiff paid $28,299.09; and that the remainder of said tax was paid on declaration of estimated tax or withheld from plaintiff's wages or salaries.

IV

The allegations in paragraph 4 are denied, except that it is admitted that plaintiff's income tax return for 1944 did not include a deduction in the amount of $7,263.83 for legal services by Kenneth I. McKay.

V

The allegations in paragraph 5 are severally denied.

[fol. 16]

VI

The allegations in paragraph 6 are severally denied.

VII

The allegations in paragraph 7 are admitted, except that the date of the filing and receipt of the claim for refund is denied. The said claim for refund was filed and received on March 11, 1946.

VIII

The allegations in paragraph 8 are admitted.

IX

The allegations in paragraph 9 are admitted, except that the allegations set forth in Exhibit B to the complaint are denied.

Wherefore, defendant, having answered the complaint, demands judgment that plaintiff take nothing, that the complaint be dismissed on the merits, and that it be awarded its costs according to law.

H. S. Phillips, United States Attorney for the Defendant. Arthur L. Steed, Assistant United States Attorney.

On the 9th day of May, 1949, was filed Testimony on the Final Hearing in the following words and figures to-wit:

[fol. 17] IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF FLORIDA

No. 1556—Civ.-T.

Recovery Income Tax

Final Hearing

JOSEPH T. LYKES, Plaintiff,

vs.

THE UNITED STATES OF AMERICA, Defendant

INDEX

Plaintiff's witnesses:	Direct	Cross
Netscher, Edward G.	5-8	7
Lykes, Joseph T.	9	26

EXHIBITS & STIPULATIONS:

Plaintiff's:	Original
Stipulation	3-5
Exhibit No. 1	4
Exhibit No. 2	4
Exhibit No. 3	5
Exhibit No. 4	7
Exhibit No. 5, 6, 7, and 8	8

[fol. 18] IN UNITED STATES DISTRICT COURT

[Title omitted]

PROCEEDINGS ON FINAL HEARING—July 19, 1949

Appearances:

Chester Ferguson and George W. Ericksen, of Macfarlane, Ferguson, Allison & Kelly, Tampa, Florida, Attorneys for Plaintiff; and

Fred S. Gilbert, Special Assistant to the Attorney General, Washington, D. C., and

Arthur L. Steed, Assistant United States Attorney, Tampa, Florida.

COLLOQUY

By the Court: Do you have testimony to take in this case?

Mr. Ferguson: Yes sir, if your Honor please, some.

Mr. Ferguson: If your Honor please, we have our Comptroller here just to make a computation, and Mr. Lykes also will testify.

[fol. 19] The Court: I would like for you to state to me what the case is about.

Mr. Ferguson: This is a case of Joseph T. Lykes vs. The United States of America. If your Honor please, this is a suit against the United States based on a claim for refund filed and disallowed for the payment of attorneys fees, in which Mr. Lykes is claiming $5,665.78. The case arises out of the gift tax assertion, and the question involved is whether or not it is an allowable deduction under ordinary business expense.

By the Court: Attorneys' fees?

By Mr. Ferguson: Yes sir.

The Court: Does counsel for the Government desire to make any statement with reference to the defense to the action?

Mr. Gilbert: I don't believe we care to make any statement at this time, your Honor. It is purely a question of law, as we see it, as to whether or not attorneys' fees in a gift tax contest should be deductable from his income tax.

Mr. Ferguson: May it please the Court, in conference with Mr. Gilbert, of counsel for the Government, I think he has agreed to stipulate that:

STIPULATION

The plaintiff in this action, Mr. Joseph T. Lykes, business address 17 Battery Place, New York, New York, residence 631 Esplanade, Pelham Manor, New York, during the years involved, 1940-44, and now a resident of Florida, made gifts of one thousand shares of the Common Stock of Lykes Brothers, Incorporated, a Florida Corporation, with its

principal place of business in the City of Tampa, Florida, as follows:

[fol. 20] 250 shares of said stock to Margaret K. Lykes, his wife;

250 shares of said stock to Margaret Howell Lykes, his daughter;

250 shares of said stock to Elisabeth L. Lykes, his daughter; and

250 shares of said stock to Joseph T. Lykes, Jr.;

That Mr. Lykes filed his gift tax return for the year 1940, and returned the aforesaid gifts at the value of $120.00 a share, and paid the total tax of $13,032.75, as evidenced by the return herewith offered in evidence as Plaintiff's Exhibit No. 1.

By Mr. Gilbert: No objection.

(There being no objection thereto Plaintiff's exhibit No. 1 was filed in evidence.)

Mr. Ferguson:

That on March 3, 1944 the Government issued a ninety day notice by letter directed to plaintiff, and proposed a deficiency assessment against the plaintiff on account of the gifts previously mentioned in the sum of $145,276.50, urging that the value of the stock returned by plaintiff at $120.00 a share was of the value of $915.50, as is shown by a letter which we now offer in evidence as Plaintiff's Exhibit No. 2.

Mr. Gilbert: We have no objection.

(Thereupon the letter was filed in evidence as Plaintiff's Exhibit No. 2.)

Mr. Ferguson:

[fol. 21] That subsequently, on May 22nd, 1944, the plaintiff in this action, as Petitioner, filed a petition in the Tax Court of the United States, in defense of the above asserted or proposed deficiency assessment;

That pursuant to stipulation filed on December 19th, 1946, in the Tax Court of the United States, in the aforesaid cause, wherein the Plaintiff in this action was Petitioner in

on ....., 19..

The deponent verily believes that this claim should be allowed for the following reasons:

In preparing his income tax return for the year 1944, taxpayer inadvertently omitted to include as a deduction on the return the amount of $7,263.83 paid to Kenneth I. McKay, attorney at law, Tampa, Florida for legal services rendered in connection with deficiency assessments made by the Commissioner of Internal Revenue during 1944 on Gift Tax return of the taxpayer for the year 1940. The inclusion of this allowable deduction for the taxable year involved (1944) results in a tax of $22,633.31 instead of $28,299.09 as shown on the return originally filed, an overpayment of $5,665.78. See statement attached to and made part of this claim for refund as well as amended return (form 1040) for the year 1944.)

9

(Attach letter-size sheets if space is not sufficient)

Subscribed and sworn to before me this

9th day of March, 1946

Signed .....

.....

(Signature of officer administering oath)

.....

(Title)

(SEE INSTRUCTIONS ON REVERSE)

16—15804-8

4A

Your Income.

Lykes Bros. Co., Inc.	New York City, N.Y.	$ 24,000	00

Enter total here → $ 24,000 00

3. Enter here the total amount of your dividends and interest (including interest from Government obligations unless wholly exempt from taxation) — 39,848 05

4. If you received any other income, give details on page 3 and enter the total here

5. Add amounts in items 2, 3, and 4, and enter the total here — $ 63,238 05

If item 5 includes income of both husband and wife, show husband's income here, $; wife's income here, $

How to Figure Your Tax

IF YOUR INCOME WAS LESS THAN $5,000.—You may find your tax in the tax table on page 2. This table, which is provided by law, is based on the same tax rates as are used in the Tax Computation on page 4. The table automatically allows about 10 percent of your total income for charitable contributions, interest, taxes, casualty losses, medical expenses, and miscellaneous expenses. If your expenditures and losses of these classes amount to more than 10 percent, it will usually be to your advantage to itemize them and compute your tax on page 4.

IF YOUR INCOME WAS $5,000 OR MORE.—Disregard the tax table and compute your tax on page 4. You may either take a standard deduction of $500 or itemize your deductions, whichever is to your advantage.

HUSBAND AND WIFE.—If husband and wife file separate returns, and one itemizes deductions, the other must also itemize deductions.

Tax Due or Refund

6. Enter your tax from table on page 2, or from line 15, page 4 — $ 29,117 13

7. How much have you paid on your 1944 income tax?

(A) By withholding from your wages (Attach Withholding Receipts, Form W-2) — $ 4,554 40

(B) By payments on 1944 Declaration of Estimated Tax — 1,929 42

Enter total here → 6,483 82

8. If your tax (item 6) is larger than payments (item 7), enter BALANCE OF TAX DUE here — $ 22,633 31

9. If your payments (item 7) are larger than your tax (item 6), enter the OVERPAYMENT here — $

Check (✓) whether you want this overpayment: Refunded to you ☐; or Credited on your 1945 estimated tax ☐

If you filed a return for a prior year, what was the latest year? 1943

To which Collector's office was it sent? 2nd Dist. Custom House, N.Y.

To which Collector's office did you pay amount claimed in item 7 (B), above? " " " "

Is your wife (or husband) making a separate return for 1944? Yes

If "Yes," write below:

Name of wife (or husband) Mrs. Margaret K. Lykes

Collector's office to which sent Custom House, N. Y.

I declare under the penalties of perjury that this return (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is a true, correct, and complete return.

(Signature of person (other than taxpayer or agent) preparing return) (Date)

(Name of firm or employer, if any)

(Signature of taxpayer) (Date)

(If this is a joint return of husband and wife, it must be signed by both)

(SEE TAX TABLE BELOW)

16—41002-1

line 8) ____ $ ____

10. Gross profit (line 1 less line 9) ____ $ ____

20. Total of lines 11 to 19 ____ $ ____

21. Total of lines 7 and 20 ____ $ ____

22. Net profit (or loss) (line 1 less line 21) ____

Schedule D.—GAINS AND LOSSES FROM SALES OR EXCHANGES OF CAPITAL ASSETS, ETC.

1. Net gain (or loss) from sale or exchange of capital assets (from separate Schedule D) ____

2. Net gain (or loss) from sale or exchange of property other than capital assets (from separate Schedule D) ____

Schedule E.—INCOME FROM PARTNERSHIPS, ESTATES AND TRUSTS, AND OTHER SOURCES

Name and address of partnership, syndicate, etc. ____ Amount, $ ____

Name and address of estate or trust ____ Amount, ____

Other sources (state nature) Directors Fees Amount, 390 CO

Total ____

Total income from above sources (Enter as item 4, page 1) ____ $ ____

Schedule F.—EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULES B AND C

1. Kind of property (If buildings, state material of which constructed)	2. Date acquired	3. Cost or other basis (Do not include land or other nondepreciable property)	4. Assets fully depreciated in use at end of year	5. Depreciation allowed (or allowable) in prior years	6. Remaining cost or other basis to be recovered	7. Estimated life used in accumulating depreciation	8. Estimated remaining life from beginning of year	9. Depreciation allowable this year
					$			$

Schedule G.—EXPLANATION OF COLUMNS 4 AND 5 OF SCHEDULE B, AND LINES 6, 14, AND 17 OF SCHEDULE C

1. Column or Line No.	2. Explanation	3. Amount	1. Column or Line No.	2. Explanation	3. Amount
		$			$

16—41002-1

expenses	Net Expenses (not compensated by insurance or otherwise)	$		
	Enter 5 percent of item 5, page 1, and subtract from Net Expenses			
	Allowable Medical and Dental Expenses. See Instruction for limitation			
Miscellaneous (including alimony, amortizable bond premium, special deduction for the blind, etc.)	Solicitation Exp. directly relating to the improvement & expansion of the business & not recoverable from the Corporation	$		
	Legal fees in re deficiency assessment		574 08	
	Total Miscellaneous Deductions see statements attached			
	TOTAL DEDUCTIONS		7,263 83	9,837 91

TAX COMPUTATION—FOR PERSONS NOT USING TAX TABLE ON PAGE 2

1. Enter amount shown in item 5, page 1. This is your Adjusted Gross Income		$11,716 09
2. Enter DEDUCTIONS (if deductions are itemized above, enter the total of such deductions; if adjusted gross income (line 1, above) is $5,000 or more and deductions are not itemized, enter the standard deduction of $500)		C2,238 05
3. Subtract line 2 from line 1: Enter the difference here. This is your Net Income		$
4. Enter your Surtax Exemptions ($500 for each person listed in item 1, page 1)		11,716 09
5. Subtract line 4 from line 3. Enter the difference here. This is your Surtax Net Income		61,521 96
6. Use the Surtax Table in instruction sheet to figure your Surtax on amount entered on line 5. Enter the amount here		$ 500 00
7. Copy the figure you entered on line 3, above. (If line 3 includes partially tax-exempt interest, see Tax Computation Instructions)		61,021 96
8. Enter your Normal-Tax Exemption ($500 if return includes income of only one person; otherwise see Tax Computation Instructions)		27,580 27
9. Subtract line 8 from line 7, and enter the difference here		61,521 96
10. Enter here 3 percent of line 9. This is your Normal Tax		$ 500 00
11. Add the figures on lines 6 and 10, and enter the total here. (If alternative tax computation is made on separate Schedule D, enter here tax from line 15 of Schedule D)		51,021 96
		$1,530 66
If you used the $500 standard deduction in line 2, disregard lines 12, 13, & 14, and copy on line 15 the same figure you entered on line 11		29,117 13
12. Enter here any income tax payments to a foreign country or U. S. possession (attach Form 1116)	$	
13. Enter here any income tax paid at source on tax-free covenant bond interest		
14 Add the figures on lines 12 and 13 and enter the total here		
15. Subtract line 14 from line 11. Enter the difference here and in item 6, page 1. This is your tax		29,117 13

U. S. GOVERNMENT PRINTING OFFICE : 1944 16—41002-1

that action, and the Commissioner of Internal Revenue was Respondent, Docket 5053, a total deficiency assessment of $15,612.75 was entered, as evidenced by a copy of the stipulation which we offer in evidence as Plaintiff's Exhibit No. 3.

Mr. Gilbert: We have no objection.

(Thereupon the paper was filed in evidence as Plaintiff's Exhibit No. 3.)

Mr. Ferguson:

It is further stipulated that the Plaintiff in this action paid to K. I. McKay, an attorney at Law, at Tampa, Florida, the sum of $7,263.83.

Thereupon the Plaintiff, to maintain the issues on his behalf, then and there produced and caused to be sworn as a witness, EDWARD G. NETSCHER, who testified as follows:

[fol. 22] Testimony of EDWARD G. NETSCHER:

Direct examination.

Questions by Mr. Ferguson:

Q. State your name, please?

A. Edward G. Netscher.

Q. What is your business or profession?

A. I am comptroller for Lykes Brothers, Incorporated, and subsidiary companies.

Q. What is your educational background, in so far as accounting is concerned?

A. I am a Bachelor of Commercial Science, New York University; I am a C.P.A., New York and Florida; and I have been a tax supervisor and public accountant.

Q. Mr. Netscher, did you examine the income tax return filed by the plaintiff in this action for the year 1944?

A. I did.

Q. Did you take the information shown on that return and by giving the necessary consideration to the payment of the sum of $7,263.83 re-compute and calculate the overpayment by the payment during that year, after deducting that amount?

A. I did.
Q. Is this a true and correct calculation?
A. Yes sir; it is.

Mr. Ferguson: We offer that in evidence as Plaintiff's Exhibit No. 4.

[fol. 23] Mr. Gilbert: We have no objection.

(The Computation was filed in evidence as Plaintiff's Exhibit No. 4.)

Mr. Ferguson:

Q. Assuming, Mr. Netscher, that the aforesaid amount paid to Mr. K. I. McKay by the plaintiff in this action on August 30th, 1944, is a proper deduction from income taxes, what amount would the plaintiff be entitled to receive in this action by reason of said payment?
A. $5,665.78.

Mr. Ferguson: That is all.

Cross-examination.

By Mr. Gilbert:

Q. Did you prepare the original and amended returns yourself, Mr. Netscher?
A. No sir. I did not prepare the original return. I prepared the amended return.
Q. And the claim for refund?
A. Yes sir. And the claim for refund.
Q. And made this computation, yourself?
A. Yes sir, I did.

[fol. 24] Redirect examination.

By Mr. Ferguson:

Q. Mr. Netscher, I hand you herewith a series of letters consisting of four, the first dated January 2nd, 1947, the second dated January 13th, 1947, the third dated June 20th, 1947, and the fourth dated October 30th, 1947, and I ask you to examine these and state whether or not you prepared them in connection with this claim for refund which is being sued on in this action?

A. Yes sir. I did.

Q. What happened to the originals?

A. The originals were filed with the officials of the Bureau.

Q. Are those exact copies thereof?

A. They are. One of those I had Mr. Lykes sign. I did not sign it myself.

Mr. Ferguson: We offer those letters in evidence as Plaintiff's Exhibits 5, 6, 7, and 8, in accordance with the dates.

Mr. Gilbert: We would like to object to those, your Honor. These are statements prepared by Mr. Netscher giving his opinion as to the law applicable to the suit here when it was pending before the Bureau, and we believe that is a question for the Court to determine. If the plaintiff wishes to file a brief, that is up to him; but we do not think these are properly admissible in evidence, and they are immaterial.

[fol. 25] By the Court: Is there anything in the letters beyond a statement?

By Mr. Ferguson: I think, if your Honor please, that they are material, because it is an explanation of the claim.

The Court: To that extent they will be received. To the extent that they cover what the law is, the Court will disregard them. If they supplement the facts, they will help us to that extent.

Thereupon the Plaintiff, JOSEPH T. LYKES, to maintain the issues on his own behalf, was then and there duly sworn, and testified as follows:

Direct estimation:

Questions by Mr. Ferguson:

Q. State your name, please sir?

A. Joseph T. Lykes.

Q. You are the Plaintiff in this action, are you?

A. Yes sir.

Q. Mr. Lykes, what is your business or profession?

A. President of Lykes Brothers, Incorporated, and certain of their subsidiary companies.

Q. Mr. Lykes, where were you residing during the year 1940 and the year 1944?

[fol. 26] A. 631 Esplanade, Pelham Manor, New York.

Q. Are you now a citizen and resident of Florida?

A. I am.

Q. And you have been a resident here for the past year or more?

A. Yes sir.

Q. Mr. Lykes, will you please explain to the court the reasons prompting you to make the gifts that you made in 1940 which form the subject of this controversy?

Mr. Steed: If the Court please, at this time the Government objects on two grounds:

In the first place, it is requesting this witness to expand and explain orally the terms of a written instrument, under seal, as evidenced by the gift tax return, and I call the Court's attention to the gift tax return, and would like for the court to look at it. On the reverse side of the gift tax return, your Honor, this witness explained the reason for the gifts. Reading from the return:

250 shares of the common stock of Lykes Brothers, Inc., motive, love; and the same thing as to the other donees, motive, love.

Any explanation, in addition to that, is contrary to every rule of evidence.

By the court: I do not believe I need to hear your argument. I am getting ready to sustain your objection, unless you want to make a speech.

[fol. 27] By Mr. Ferguson: If your Honor please, I do not think the fact that you state one reason in the gift tax return would preclude you from stating any other reason that you may have had, if it is not in contradiction of or in variance with.

By the Court: What is the purpose.

By Mr. Ferguson: The purpose is to show the business purpose connected with the gifts, and to show that it is for protection and conservation.

By the Court: Let me get this point clear: Mr. Lykes gave to his wife and children a thousand shares of Lykes

Brothers stock, and in making a report of that gift he reported the value of that stock at $120.00 a share, and paid the gift tax accordingly on the gifts that he had made to his family. The Government comes along and says the value of that stock as you reported it is in error; that it is worth more than you reported, and the gift tax you owe is more than the amount your paid. Is not that the issue?

Mr. Ferguson: Yes sir, except it is very exaggerated. It is about fifteen times "what you said".

By the Court: Well, it is more than the amount you paid, and Mr. Lykes entered into a contest with the Government over that issue, as to whether or not it was worth more than he paid—it being a stock of no market value in so far as the Exchange is concerned—I do not know whether the record shows that in the case—and he hired an attorney to represent him in that controversy with the Government. Is that right?

[fol. 28] Mr. Ferguson: That is right, sir.

The Court: And the Government is now saying that he is not entitled to that amount that he paid an attorney to represent him in the controversy with the Government over the value of the stock that he gave to his family. Does that state the question?

Mr. Ferguson: Yes sir; but we are contending that we are entitled to that for these additional reasons, as set forth in our complaint:

The business purposes for the giving of this stock, plus the *exorbitant and confiscatory assessment* made by the Government in the sum of a hundred and forty five thousand dollars, when the Government admitted that we did not owe but fifteen thousand dollars. In other words, they asserted against this man ten times what we were required to pay; and this case, as we see it, is entirely different from the ordinary case, where an assertation is reasonable. Here we have got an entirely different state of facts, one where this man was asserted a hundred and forty-five thousand dollars and actually paid fifteen thousand dollars in the final wind up, showing that the *assessment*, in itself, was so arbitrary and confiscatory and unreasonable that it should not have been made.

By the Court: The record that you have introduced shows that.

Mr. Ferguson: It does not show the business purpose behind these gifts.

By the Court: Does the Government contest this case in [fol. 29] any sense of raising the question before this court as to when a man makes a gift and the Government says the gift is reported too low he cannot hire counsel to represent him in the controversy with the Government over that issue?

By Mr. Ferguson: No sir.

The Court: It is not in any sense that way?

Mr. Ferguson: No sir. They are not saying whether we do it or not. What they are saying is that if you did hire and pay counsel then you cannot show that payment as a deduction on your income tax.

The Court: That is what I say. The Government says that you cannot claim it as an expense in your income tax. The gift tax is not involved in this case?

Mr. Ferguson: The gift tax, itself, no sir. The question is, under the peculiar facts and circumstances of this case, is the Plaintiff entitled to claim the amount paid as a deduction on this income tax return.

The Court: Let me ask another question:

Is there any limitation in the law against a man who makes a gift including in his income tax return any expenses that he incurs and that he subsequently incurs in defending a controversy raised by the Government as to the value he places upon——

By Mr. Ferguson: If your Honor please, let me answer that question in this way:

[fol. 30] The basic law, in my opinion, permits that expense to be deducted. The regulation written by the Department, pursuant to the basic law, indicates to the contrary on certain given statements of facts; but the basic law, itself, provides:

Non trade or non business expense, in the case of an individual, all of the ordinary and necessary expense paid or incurred during the taxable year for the production of income, or for the management, conservation or mainte-

nance of property held for the production of income, is a proper deductible expense.

Now, it is our contention, if your Honor please, under the facts which I hope to develop from Mr. Lykes, and as set forth in the Petition, what action he took by reason of the unusual circumstances here shown by the record is clearly within the above provisions for the management, conservation and maintenance of his property, and, as such, deductible for income tax purposes.

The Court: Is it your contention that, under the law, or under any regulation that has been promulgated by the Bureau, that the expense incurred by Mr. Lykes in this case in defending the action brought against him on a deficiency in the tax on the gifts is not a deductible expense in his income tax for specific reasons other than the law.

Mr. Gilbert: No sir. We believe the law, your Honor, as written—as there is no provision in the law for the deduction of attorneys' fees for the gift tax contest, no provision for the deducting of that particular expense—the regula- [fol. 31] tions written by the Commissioner of Internal Revenue that were promulgated by the Secretary of the Treasury in the Revenue Code says that attorneys fees paid for contest of the gift tax is not taxable; and we contend that the gift tax regulations are properly promulgated under the Code.

By the Court: Now, let me ask you this:

You are objecting to the question that has just been propounded to this witness. Does the answer to that question in any way affect the position that the Government is taking in this case with reference to the right of the plaintiff to get the benefit of this payment?

By Mr. Steed: If the Court please, I would like to answer that question:

It does in this respect:

The plaintiff endeavors to recover this money from the Government on the income tax return of 1944, and in such endeavor they have gone off into the reasons why this gift had something to do with the production and maintenance of income.

Even if the law allowed the payment of attorneys' fees as a deduction on his income tax return, this question pro-

pounded to Mr. Lykes is an effort to get him to go into a greater length than he did on his gift tax return in explaining these deductions, which is an enlargement on a written instrument filed by Mr. Lykes, and on the back of the gift tax return, under Schedule A, Description of Gift, and Donee's Name and Address, we have here in the taxpayer's own words the motive for the gift. If we allow the tax- [fol. 32] payer to expand on the motive given in this written statement, under seal, it is against the rule of evidence.

By the Court: Mr. Steed, your own statement makes the Government's contention untenable, and the court so rules.

(Thereupon the question was read to the witness as follows):

Q. Mr. Lykes, will you please explain to the court the reasons prompting you to make the gifts that you made in 1940 which form the subject of this controversy?

A. As indicated on the return, love and affection, of course, was one motive. In addition was a desire to create for the recipients of the gifts an independent status. And, in addition, this is a family company which originally was a partnership and subsequently incorporated in 1910, by a number of brothers, and as the younger brothers, including myself, came of age, and available for work, they were given an interest in the business, and as the years went on, trying to perpetuate the interest, the sons, nephews and sons-in-laws, and it was the accepted custom or policy of the older brothers, as we accumulated some value, to make gifts to our children, first, with the boys in the family to instill interest to carry on, *and to further fortify our remaining interest in the company;* and also to enlist the interest of in-laws, who were husbands of our daughters, as a good business proposition.

Our Company has never had their stock on the market. [fol. 33] In fact, there has been no real market increase or any sale of a substantial amount of stock as far as I know.

So, always, it was the general practice by my brothers, as well as myself, of creating a situation of that kind; and up to date that has had, in our judgment, a beneficial effect, because most of our sons and several of our relatives have become actively engaged in our business and are important officials in the business today.

Q. Mr. Lykes, what effect did that have upon the continuation and soundness of the organization of Lykes Brothers in which you own your stock?

A. Well, it creates, in our judgment, a management of continuity and of more interest than would otherwise be the case, because the availability of stock to disinterested people in our executive branch is not up to date, at least, accessible as a benefit, or as an added inducement, for outside managerial help.

Q. What conditions, Mr. Lykes, about 1940, accentuated managerial problems and brought this more forcibly to your attention, and to the attention of your other brothers?

A. It was a question brought on by the war, and a variation of economic reasons generally, and the fact that the older managing group among the brothers were getting older in age, which rather emphasized the prudence of fortifying our business from a future managerial standpoint.

Q. Mr. Lykes, what is the principal nature of the business [fol. 34] conducted by Lykes Brothers, Incorporated, individually and through subsidiaries?

A. Originally, the cattle business, ranching, packing houses, cattle trading; latterly extending to extensive steamship operations through a subsidiary company, Lykes Brothers Steamship Company, Incorporated, and related industries such as stevedoring operations.

Q. What are the characters of these business-, as relates to hazards, Mr. Lykes?

A. The steamship business is admittedly a very hazardous operation, because it is dependent upon so many factors, international trade and political conditions, as well as economic, and the character of the business is that it runs more or less in cycles, a period of good and a longer bad period.

Q. And the nature of the business is such that it is of the utmost importance that the continuity of management be interested and experienced?

A. Absolutely.

Q. What other factors did occur that confirmed the judgment of yourself and the other brothers to enlist the younger generation to become actively identified and to become interested in the management of the Lykes enterprises?

A. I think it has proved sound, and we have quite a number of our executives today who are interested in the business from an ownership standpoint by virtue of this policy.

Q. Take your own son, for instance, Joseph T. Lykes, Jr., [fol. 35] to whom you made gifts in 1940, did he follow what you thought he would and become identified with the Company?

A. He has been, since his release from the Navy, actively identified in the business, and has taken increased responsibility, and functioning as I hoped he would.

Q. Does he also have any official connection with any of the business?

A. He is a Director today of both the parent company and the Steamship Company.

Q. Mr. Lykes, were there any deaths that ensued in the early part of 1940 that put more responsibility on the younger generation that were brought in under the plan that you testified about?

A. Well, we had several unfortunate losses among our top personnel and those who had been the guiding factors beginning in 1940.

Q. It is true, is it not, that in 1941, Mr. T. M. Lykes, who was directing the ranch operations, died; and in 1942, Mr. H. T. Lykes; and in 1943, Mr. J. M. Lykes, who was then head of the Steamship Company; also died, did they not?

A. That is correct.

Q. And you also, did you not, suffer the loss of the Executive Vice-President of Lykes Brothers, Incorporated, in the death of Mr. Reuben Tipton?

A. Yes sir.

[fol. 36] Q. Mr. Lykes, did you suffer the loss of any executive who was handling the operations in Cuba, also?

A. Yes sir. Mr. F. A. Morris, who was in charge of our Cuban property.

Q. And have the younger Lykes generation taken over and assumed the responsibilities caused by the death of these executives?

A. That is correct.

Q. Mr. Lykes, what were your holdings of Lykes' Brothers common stock of the character that you gave in 1940, during that year, if you know?

A. The character was the common stock.

Q. And what were your holdings?

A. My holdings at the beginning of 1940 were approximately three thousand shares.

Q. And during that year you gave one thousand shares for the reasons that you have indicated?

A. Yes sir.

Q. What were the approximate number that you still owned, after making these gifts in 1940, in the Company?

A. Approximately two thousand.

Q. Have Mr. Morris responsibilities and place been taken over by the second generation, a son-in-law?

A. Yes sir.

[fol. 37] Q. In determining the valuation of the common stock that you gave in 1940, as reported on your gift tax return, how did you arrive at that value?

By Mr. Gilbert: the valuation of stock is not involved, but merely the attorney's fees?

By the Court: I am not so sure, since the case has taken the turn that it has. It might not be important. Let's see how arbitrary that value was, as made. Objection overruled.

A. I took, as a guide, the value that had been placed on the only arms length transaction of importance during that year of which we had knowledge, which was the sale of a number of shares, several hundred, as I recollect, by Mr. Morris, who was identified with the Company, and practically in control of our Cuban business, to other executives of the Company.

Q. Did you also take into consideration the financial statements, with which you were familiar, and other considerations arising from the business?

A. The hazards and the business appraisal, that might be a fair valuation; and the primary consideration I think was establishing its market value as nearly as we could.

Q. Mr. Lykes, what are your present holdings, approximately, in Lykes Brothers, of the class of stock that you gave?

A. Approximately eighteen hundred shares.

Q. Mr. Lykes, you have heard the stipulation of counsel that you paid Mr. K. I. McKay, on August 30th, 1944, the

[fol. 38] sum of $7,263.83, as evidenced by your check and memorandum on the stub. Will you please tell the Court why you paid Mr. McKay that sum of money?

A. Well, what brought about the necessity was a ninety day letter on the valuation placed by the Government, and the tax involved, and which,

No. 1. I was not in a position to pay because practically all of my assets were in this stock.

Secondly. I was convinced that it was an arbitrary figure which could, in no manner or reason, by any business standards with which I was aware, have been maintained. It was practically confiscation, in my judgment. I would not like to express my feelings when I first got it. It might not be appropriate here. But, in any event, it just became necessary for me to get some relief, and, of course, the only way I thought I could get relief was for me to adopt the course I did, which was to get legal help. And, then, also involved was my whole estate. If, at that time, I had accepted the Government's *proposed assessment,* to meet that situation I would have had to sell more of the stock, which, as far as I knew, at the price I could get, would mean the wrecking practically, of my holdings in the Company, which, naturally, I wanted to avoid.

By the Court:

Q. The question is: *Did you hire Mr. McKay to represent you in the controversy with the Government over the assessment that they had imposed upon you in connection with the gifts?*

[fol. 39] A. The *assessment itself was a consideration,* but I was *not prepared to pay such assessment,* and also for the protection of my assets.

By the Court:

Q. The question is: Did you hire Mr. McKay to represent you in connection with the matter?

A. Yes sir, and all things connected therewith.

By the Court:

Q. And the money that you paid Mr. McKay is exclusively applicable to his representation of you in this controversy?

A. Correct.

By the Court: That is the point I wanted to clear up in the record.

Cross-examination.

By Mr. Gilbert:

Q. Would you tell us, Mr. Lykes, how many shares of this Class B common stock were outstanding in 1940?

A. You mean total?

Q. Yes sir. Is it correct that there were twenty-five thousand shares outstanding at that time?

A. I think so. It was approximately that.

Q. At the time you made the gifts there were twenty-five thousand shares outstanding?

[fol. 40] A. Yes sir; I would say so.

Q. And you, I believe, testified that you had three thousand shares, yourself, at that time?

A. That is correct.

Q. It is correct that you gave 250 shares to your wife, Margaret K. Lykes?

A. Yes sir.

Q. And 250 shares to your daughter, Margaret H. Lykes?

A. Yes sir.

Q. And 250 shares to your daughter, Margaret L. Lykes?

A. Yes sir.

Q. And 250 shares to your son, Joseph T. Lykes, Jr.?

A. Yes sir.

Q. You thus gave only one per cent of this stock to each one of your wife, daughters and son, is that correct?

A. Yes sir.

Q. It is true, is it not, that your two daughters and your son were all three minors at that time?

A. In 1940 I don't think they were all minors. My son, I think, in 1940 was 21. I think he became 21 in 1940.

Q. This was early in the year 1940?

[fol. 41] A. He was practically grown. He was in his last year of college.

Q. He was nearly 21?

A. At the date of the gift I think he was under 21, to be specific.

Q. The two daughters and the son were under 21 at that time?

A. No sir. I think my oldest daughter was 21, but the other two were under 21.

Q. All three, the two daughters and your son, lived with you at 631 Esplanade, Pelham Manor, New York?

A. That is true.

Q. Your son did not take any part in the business until he got out of the Navy, I believe you testified?

A. No sir. He worked during the Summers, but he had no continuous participation in the Company; but he worked during the Summers prior thereto.

Q. It was just a Summer job?

A. Learning the business.

Q. He was not present at your stockholders' meetings, was he?

A. No sir.

Q. You first learned of this proposed deficiency, I believe you testified by this ninety day letter, which was issued in March, 1944; is that correct?

A. That is correct.

[fol. 42] Q. And you did not make any gifts of this stock between the time that these thousand shares were given, in February, 1940, to March, 1944, did you?

A. I don't know. I will have to refer to the records to be accurate, if I may.

There were no gifts. I made no gifts during the years 1941, 1942 and 1943.

Q. Mr. Lykes, your wife and your two daughters did not take any active part in this Corporation's management after you made these gifts of stock to them, did they?

A. That is correct.

Q. They did not?

A. They did not.

Q. When did your son get out of the Navy?

A. He went in the Navy in 1941 and I think he was out in 1945.

(Thereupon the plaintiff announced that he rested his case.)

The Court: Do you have any testimony?

Mr. Gilbert: We have no testimony, your Honor.

The Court: The court will take this case under advisement. You gentlemen, I suppose, would rather file briefs.

Mr. Ferguson: I would like to, your Honor.

The Court: How long would you gentlemen want for [fol. 43] your briefs? You may have two weeks after you get the testimony from the Reporter, Mr. Ferguson, and you may have the same time for the Government.

I find that it is beneficial to the Court in all cases to have counsel for both sides file their briefs with me at the same time, and I get straight out reaction to the law in question; and I will give you both ten days after you receive each other's brief to file a reply; and two weeks after the receipt of the transcript. If you need more I can give it to you. Sometimes you people that work for the Government are in a jam.

Ten days after the receipt of the transcript.

Mr. Gilbert: We were prepared to argue it this morning, your Honor.

The Court: If there is any particular matter that you want to argue, I will listen to you; but I think I would like to have a brief. I could not decide it without checking the testimony.

Reporter's Certificate (omitted in printing)

[fol. 44] IN UNITED STATES DISTRICT COURT

MEMORANDUM DECISION—Filed June 8, 1949

This is a suit to recover an alleged overpayment of income taxes for the year, 1944. The question presented is whether, under Section 23(a)(2) of the Internal Revenue Code, attorney's fees paid by the taxpayer in the year 1944 in the determination of his gift tax liability for the year 1940 are allowable as a deduction from his gross income. The evidence in the case is not in dispute.

Plaintiff is and has been for many years a stockholder in Lykes Brother, Inc., a family corporation. The stock of he corporation has been closely held throughout its exist-

ence and there is not nor has there ever been an open market price for the stock. In the year 1940 plaintiff made gifts of 1000 shares of stock of the corporation, owned by him, to members of his family, as follows:

250 shares to Margaret K. Lykes, his wife;
250 shares to Margaret H. Lykes, his daughter;
250 shares to Elizabeth L. Lykes, his daughter;
250 shares to Joseph T. Lykes, Jr., his son.

It appears from the testimony that one of the daughters had reached her majority at the time of the gifts, but the other two children were minors. All of the children made their home with the taxpayer, were unmarried and neither the wife nor the children took any part in the management of the business of Lykes Brother, Inc., at the time of the gifts.

[fol. 45] The motive for the gifts, as stated in the taxpayer's gift tax return, was love. The taxpayer testified to additional motives, the principal of which was the accepted custom or policy of himself and his brothers to make such gifts to their children to insure continuity of the ownership and management of the company. The evidence shows this custom had been pursued by other members of the Lykes family, who were blessed with children.

At the time the gift tax return was filed taxpayer valued the stock at $120.00 per share and paid a gift tax thereon in the sum of $13,032.75. The taxpayer testified he took as a guide in determining the value of the stock the only arm's-length transaction of importance during that year, of which he had knowledge which was the sale of several hundres shares by an executive (not a member of the Lykes family) to other executives of the company. He testified he also took into consideration the hazards then confronting the business and reached the conclusion that the market value established by the sale represented the fair value of the stock at the time.

On March 3, 1944 the Commissioner of Internal Revenue formally notified taxpayer that a determination of his gift tax liability for 1940 disclosed a deficiency of $145,276.50 and a deficiency in that amount was assessed against taxpayer. He also was notified of his right to petition the tax court for a redetermination of such deficiency liability.

Taxpayer engaged K. I. McKay to represent him in this matter and a Petition for Re-determination of the liability was filed with the tax court. After taxpayer's attorney had prepared and filed such Petition and prepared his case for trial, a compromise settlement was reached and the Tax Court, pursuant to stipulation of the parties, found a deficiency in taxpayer's gift tax return in the sum of $15,[fol. 46] 612.75, which was promptly paid. The taxpayer paid his attorney $7,263.83 in the year 1944 for services in this matter. No question is raised as to the reasonableness of the amount paid for the services rendered. If the payment is a deductible expense from gross income for the year, as taxpayer claims, he is entitled to recover $5,665.78 with interest in this case.

The taxpayer claims that the payment of $7,263.83 as attorney's fees was an allowable deduction under Section 23(a)(2) of the Internal Revenue Code in as much as the payment was an "ordinary and necessary expense paid or incurred during the taxable year . * * * for the management, conservation or maintenance of property held for the production of income." He contends the payment was made, not as the result of an ordinary contest concerning the valuation of ordinary personal gifts, but that it was a payment of legal expenses incurred to forestall the collection by the Government of an assessment of a tax which was so clearly arbitrary and capricious that in fact, it had nothing to do with the gift on which it was based. He contends further that had it been successfully enforced against him it would have substantially destroyed his holdings in Lykes Brothers, Inc., and would have confiscated most of the property held by him for the production of income.

The Commissioner contends that the law of the case is clearly stated in Treasury Regulation 111, Section 29.23(a) 15(b) as amended by TD 5513. This Regulation provides that expenses paid or incurred by an individual in the determination of gift tax liability, with certain exceptions not applicable here, are not deductible from gross income, even though property held by taxpayer for the production of income must be sold to satisfy an assessment for such tax liability. It is well established that such Treasury Regula-[fol. 47] tions have the force and effect of law if not in conflict with expressed statutory provisions. Maryland

Casualty Company v. U. S., 251 U. S., 342; U. S. v. Grimaud, 220 U. S., 506.

Section 23(a)(2) of the Internal Revenue Code, relied upon by taxpayer, provides:

> "Deductions from gross income. In computing net income there shall be allowed as deductions:
>
> (2) Non-trade or non-business expenses. In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

There is no statute specifically allowing or prohibiting deductions from gross income of attorneys' fees for services rendered in relation to advice or litigation in respect of any Internal Revenue taxes.

Treasury Regulation III, Section 29.23(a)-15(b), as amended by T. D. 5513, relied upon by Commissioner, provides:

> "Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are al- [fol. 48] locable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income."

The only Appellate Court decision bearing upon the precise question here presented is Cobb v. Commissioner of Internal Revenue, decided by the U. S. Court of Appeals, Sixth Circuit, April 4, 1949. That court held that under the stipulated and undisputed facts in that case the attorney's fees there paid were not deductible. That case came to the Court of Appeals from a decision of the Tax Court which had also disallowed the deduction. The taxpayer in that case, as does the taxpayer here, relied upon Bingham et al. v. Commissioner of Internal Revenue, 325 U. S. 365, as supporting his position for the deduction. In the Cobb case the Court of Appeals held that the Bingham case was not controlling and went to considerable pains to point out its reasons for so holding. This court has carefully reviewed these reasons, but finds itself unable to follow them.

This case presents the question, in relationship of the sovereign with its subjects, as to whether Congress has dealt justly with the taxpayer. Congress has imposed gift taxes and has authorized the Commissioner of Internal Revenue to assess an additional gift tax when, in his opinion, there is a deficiency in the gift tax paid by the taxpayer. The Commissioner may do this without giving the taxpayer an opportunity to be heard and the deficiency tax so imposed becomes final upon the taxpayer unless the procedure prescribed by the law is followed, as was done in this case.

To construe the law as giving to the Commissioner the power to assess a taxpayer with a deficiency tax greatly in [fol. 49] excess of what he owes and to hold that such law denies to the taxpayer the right to contest such assessment, except at his own personal expense, just isn't justice under the law. The statute in question gives the Commissioner no such power and the courts should not permit the Commissioner to write such power into the law by a regulation adopted by him.

The inconsistency of this Treasury Regulation is illustrated by the fact that while it denies the right of the taxpayer to deduct expenses paid or incurred in the determination of a gift tax assessment it authorizes the deduction of expenses incurred in litigation to determine whether the expenses paid or incurred in the gift tax assessment are deductible.

In this connection it is noted that in the Bingham case

the same position was taken by the Commissioner as is here taken; that is, that a Treasury Regulation prohibited the deduction.

The Supreme Court in the Bingham case, said:

> "So far as this regulation purports to deny deductions of litigation expenses unless it is to produce income it is not in conformity with the statute X X X."

This court has reached the opinion that this is also true in this case and the court finds and holds that the Treasury Regulation is in conflict with the expressed stautory provision authorizing the deduction.

A Judgment will be entered in favor of the taxpayer, in conformity with this Memorandum Decision.

Dated at Tallahassee, Florida, this 3rd day of June, 1949.

(S.) Dozier A. Devane, United States District Judge.

[fol. 50] IN UNITED STATES DISTRICT COURT

JUDGMENT—Filed November 15, 1949

The court having filed herein its memorandum opinion directing the entry of judgment in favor of the plaintiff and against the defendant; it is

Adjudged that the plaintiff, Joseph T. Lykes do have and recover of the defendant The United States of America, the sum of $5,665.78 with interest as provided by law.

Dated this 8th day of June, 1949.

By the Court.

Edwin R. Williams, Clerk, by Joe A. Law, D. C.

The clerk of the above court is hereby directed to enter a judgment in this case in accordance with my memorandum decision of June 3, 1949 in the above form.

Dated this 14th day of November, 1949.

Dozier A. Devane, United States District Judge.

Before me this 14th day of November, 1949. ——

——, District Judge.

[fol. 51] IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL—Filed January 14, 1950

Notice is hereby given that the United States of America, defendant above named, hereby appeals to the Circuit Court of Appeals for the Fifth Circuit from the judgment entered in this action on the 14th day of November, 1949.

Arthur L. Steed, Assistant United States Attorney, Attorney for Appellant, United States of America, 308 Post Office Building, Tampa, Florida.

IN UNITED STATES DISTRICT COURT

AMENDED NOTICE OF APPEAL—Filed February 23, 1950

Notice is hereby given that the United States of America, defendant above named, hereby appeals to the Circuit Court of Appeals for the Fifth Circuit from the Judgment entered in this action on the 14th day of November, 1949, and filed on the 15th day of November, 1949.

(S.) Arthur L. Steed, Assistant United States Attorney, Attorney for Appellant, United States of America, 308 Post Office Building, Tampa, Florida.

[fol. 52] Motion for Extension of Time to File Record and Order Granting Same (Omitted in Printing)

[fol. 53] STIPULATION OF RECORD ON APPEAL—(Omitted in Printing)

[fols. 54-56] MOTION FOR TRANSMITTAL OF ORIGINAL EXHIBITS AND ORDER THEREON—(Omitted in Printing)

[fol. 57] CLERK'S CERTIFICATE—(Omitted in Printing)

[fol. 58] That thereafter the following proceedings were had in said cause in the United States Court of Appeals for the Fifth Circuit, viz:

ARGUMENT AND SUBMISSION

Extract from the Minutes of March 12, 1951

No. 13156

UNITED STATES OF AMERICA

versus

JOSEPH T. LYKES

On this day this cause was called, and after argument by Francis W. Sams, Esq., Special Assistant to the Attorney General, for appellant, and George W. Erickson, Esq., for appellee, was submitted to the Court.

[fol. 59] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 13,156

UNITED STATES OF AMERICA, Appellant,

versus

JOSEPH T. LYKES, Appellee

Appeal from the United States District Court for the Southern District of Florida

April 27, 1951

Before Holmes, McCord and Strum, Circuit Judges

OPINION OF THE COURT.—Filed April 27, 1951

Strum, Circuit Judge: This is a suit to recover an alleged overpayment of income tax for the year 1944. The controlling question is whether, in computing the plaintiff-taxpayer's income tax for 1944 he is entitled under 26 U.S.C.A. 23(a) (2) to deduct from gross income the amount he paid

in that year as attorney's fees in contesting with the Commissioner of Internal Revenue the amount of plaintiff's gift tax liability for 1940. Judgment below was for the taxpayer.

[fol. 60] In 1940, plaintiff Joseph T. Lykes was the principal stockholder in Lykes Brothers, Inc., a closely held family corporation organized in 1910 by his elder brothers, engaged in the cattle and meat packing business. Through a subsidiary it also operates extensive steamship lines. In 1940, plaintiff made gifts aggregating 1000 shares of stock in said corporation to his wife, two daughters and a son, giving to each 250 shares. The gifts represented about one-third of plaintiff's holdings in the company. He retained the remaining two-thirds. The son and one daughter were minors. The other daughter had reached her majority. The three children were unmarried and lived with plaintiff. Previous to the gifts, they had taken no active interest in the management of the corporation's affairs. Whether they did so thereafter, does not appear.

As the stock was closely held by the Lykes' family, it had no established market value. In his gift tax return plaintiff valued it at $120 per share, which he considered a fair value, and paid thereon a gift tax of $13,032.75. The Commissioner disagreed, and on March 3, 1944 entered a deficiency assessment of $145,276.50, based upon the Commissioner's valuation. Plaintiff testified that had he been required to pay the deficiency, it would have been necessary for him to raise the money by disposing of a large part of his remaining holdings in the company, property which he held for the production of income.

Plaintiff engaged the services of an attorney who contested the deficiency assessment in the Tax Court of the United States, with the result that the assessment was settled before trial for $15,612.75, about eleven per cent of the sum originally demanded. In 1944, plaintiff paid his [fol. 61] attorney $7,263.83 for these services, but did not deduct this sum from gross income in reporting his income tax liability for that year. He later submitted a claim for refund, based upon a re-computation with the attorney's fees deducted, which claim was denied. If the fee is deductible, plaintiff's income tax for 1944 has been over paid by $5,655.78, which he would be entitled to recover.

At the trial, plaintiff testified that his motive for the gifts

was not only "love," as stated in the gift tax return, but an additional motive was to fortify the value of his retained stock by giving the younger generation an interest in the corporation, thus ensuring continuity in family ownership and management of the corporation, a practice followed by his elder brothers who organized the corporation.

Plaintiff contends that the attorney's fee is deductible from gross income, first, because the gifts were not a mere distribution of property in the ordinary sense but involved calculated business considerations, one of the purposes of the gifts being the strengthening and enhancement of the stock retained by plaintiff, so that the attorney's fee paid for contesting the deficiency assessment was an ordinary and necessary expense incurred in the "conservation" of his income producing property. Second, that the controversy between the Commissioner and plaintiff arose out of an effort by the United States to collect a deficiency assessment which was so disproportionate as to have no reasonable relation to the gifts, but was essentially a hazard to plaintiff's remaining stock in the corporation, a substantial part of which he would have had to dispose of in order to raise the money to pay the assessment.

[fol. 62] Plaintiff relies upon section 23(a) (2) of the Internal Revenue Code, 26 U.S.C.A. 23(a) (2), which provides that in computing net income for income tax purposes, there may be deducted from the gross income of an individual "all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation or maintenance of property held for the production of income." If plaintiff is entitled to deduct these fees from his gross income, he must establish that right under the statutory provisions just quoted, as there is no specific statutory provision on the subject.

The subject is dealt with, however, in Treasury Regulation 111, section 29.23(a)-15(b), as amended,[1] which has

---

[1] "Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If the property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or

the force and effect of law unless in conflict with the statute itself,[2] and which holds that the deduction here sought is unauthorized. The trial court held that insofar as this regulation purports to deny the deduction here in question it is in conflict with the statute, and hence invalid.

[fol. 63] As section 23(a) (2), supra, deals with exemptions, it is to be strictly construed. *New Colonial Company v. Helvering*, 292 U.S. 435, 440, 78 L. Ed. 1348, 1352.

The questions here involved were recently considered in *Cobb v. Commissioner*, 173 Fed. (2) 711, and determined adversely to plaintiff's contentions here. There is no tenable distinction in principle between this and the Cobb case, with which we are in accord. The *Cobb* case also clearly distinguishes the *Bingham* case, 325 U.S. 365, 89 L. Ed. 1670, here relied upon by plaintiff, which involved the deductibility of legal fees and expenses paid by the trustee of the Bingham trust estate in contesting a deficiency assessment of *income* tax which was a direct lien against the corpus of the trust, and for legal advice relating to tax and other problems arising in the management and distribution of the trust estate, functions which the trustees were under a duty to perform, and which bore directly

---

incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. *Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability* or even though, in event of a claim for refund, the amount received will be held by him for the production of income." As amended by Treasury Decision No. 5513. (Italics supplied).

[2] *Maryland Casualty Co. v. U. S.*, 251 U.S. 342, 349, 64 L. Ed. 297, 302; *Detroit Ferry Co. v. Woodworth*, (CA-6) 115 Fed. (2) 795, 797, cert. den. 312 U.S. 692, 85 L. Ed. 1128; *Houston Textile Co. v. Commissioner* (CA-5) 173 Fed. (2) 464; *Faucus Machine Co. v. Gage*, 280 U.S. 327, 74 L. Ed. 457.

upon the trust property held for income purposes. Here, the expense was the result of gratuitous personal gifts which the donor was under no duty to make, the effect of which upon his income producing property was at best indirect, remote and hypothetical.

Not all expenses are deductible under section 23(a) (2), *supra*, but only those which are "ordinary and necessary" and which bear a reasonable and proximate relation to the production of income or to the management, conservation or maintenance of property held for the production of income.[3]

As held in the Cobb case, *supra*, the true criterion is [fol. 64] that to become deductible under section 23(a) (2), the expense must be in proximate relation to the production or collection of income, or to the management, conservation or maintenance of property held for the production of income. *Kornhauser v. U. S.*, 276 U.S. 145, 72 L. Ed. 505. Even if the attorney's services in contesting and procuring a settlement of liability for the gift tax deficiency here in question conferred an indirect benefit upon the taxpayer by avoiding a possible sacrifice of income producing property in order to satisfy the lien, such expense is not one directly incurred in managing or conserving such property, nor is it a proximate result of holding property for the production of income, any more than fees or expenses incurred in any other type of personal, as distinguished from business, litigation (e.g. an ordinary tort action) which might result in a lien upon the taxpayer's income producing property. Expenses of this type do not satisfy the requirements of section 23(a) (2) because they are only indirectly, not proximately, related to the management and conservation of the taxpayer's income producing property.

Treasury Regulation 111, section 29.23 (a)-15(b), as amended, is not in conflict with section 23(a) (2) of the Internal Revenue Code, but is a reasonable and consistent interpretation thereof in the respect here under consideration. It is therefore valid and controlling. It denies the deduction here claimed by the plaintiff.

In view of the great disparity in this deficiency assess-

---

[3] Cf. as to allowable deductions, *Kornhauser v. U. S.*, 276 U.S. 145, 72 L. Ed. 505; *Commissioner v. Heininger*, 320 U.S. 467, 88 L. Ed. 171.

ment, as indicated by the comparatively modest sum accepted in settlement, it is not difficult to understand the trial court's view that to deny this deduction "just isn't justice under the law." But the principles of broad substantial justice and statutory tax law do not always coin-
[fol. 65] cide. Nor do exemptions for income tax purposes turn upon general equitable considerations. *Deputy v. duPont*, 308 U.S. 488, 493, 84 L. Ed. 416, 421.

Appellee's motion to dismiss the appeal, because filed one day late, is denied. On November 14, 1949, the District Judge made an order directing the Clerk to enter judgment in accordance with his memorandum decision of June 3, 1949. That order, together with the judgment, were filed in the Clerk's office on November 15, 1949. The judgment speaks as of the date of filing with the Clerk. Notice of entry of appeal was filed January 14, 1950, which was "within 60 days" from the entry of judgment. 28 U.S.C.A. 2107.

For the reasons stated, the judgment appealed from is Reversed.

[fol. 66] JUDGMENT

Extract from the Minutes of April 27, 1951

No. 13156

UNITED STATES OF AMERICA

versus

JOSEPH T. LYKES

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from in this cause be, and the same is hereby reversed.

[fol. 67] Clerk's Certificate

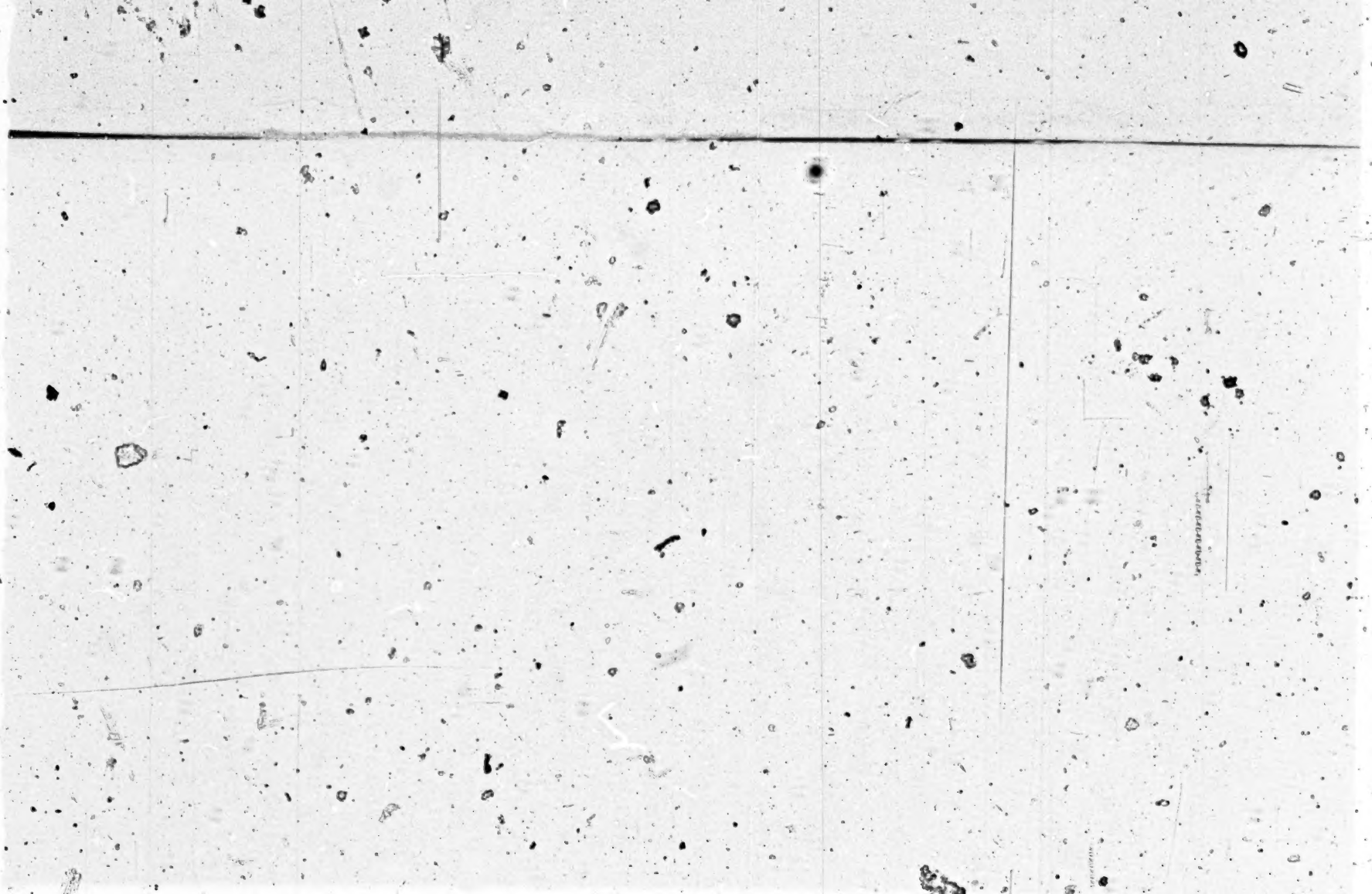
United States of America
United States Court of Appeals, Fifth Circuit

I, Oakley F. Dodd, Clerk of the United States Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 58 to 66 next preceding this certificate contain full, true and complete copies of all the pleadings, record entries and proceedings, including the opinion of the United States Court of Appeals, for the Fifth Circuit, in a certain cause in said Court, numbered 13156, wherein United States of America is appellant and Joseph T. Lykes, is appellee, as full, true and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 57 are identical with the printed record upon which said cause was heard and decided in the said Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said United States Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 2nd day of May, A. D. 1951.

Oakley F. Dodd, Clerk of the United States Court of Appeals, Fifth Circuit. (Seal.)



[fol. 65] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1951

No. 173

[Title omitted]

ORDER ALLOWING CERTIORARI—Filed October 8, 1951

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted. The case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Office-Supreme Court, U. S.
FILED
JUL 5 1951
CHARLES ELMORE CROPLEY
CLERK

No. 173

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950

JOSEPH T. LYKES,
Petitioner

vs.

UNITED STATES OF AMERICA
Respondent

(1) PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

(2) MOTION TO DISPENSE WITH THE PRINTING OF THOSE PORTIONS OF THE RECORD TRANSMITTED IN THE ORIGINAL BY THE DISTRICT COURT TO THE COURT OF APPEALS WHICH WERE NOT PRINTED IN THE COURT OF APPEALS.

CHESTER H. FERGUSON,
GEORGE W. ERICKSEN,
Attorneys for Petitioner

Of Counsel:
MACFARLANE, FERGUSON,
ALLISON & KELLY,
Tampa, Florida

THE FREE PRESS, TAMPA, FLA.

TABLE OF CONTENTS

	Page
PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT	1
Jurisdiction	2
Opinions Below	2
Questions Presented	2
Statute and Regulations Involved	3
Statement of the Case	4
Decisions of the District Court and of the Court of Appeals	6
Reasons for Granting the Petition	8
Conclusion	9
MOTION TO DISPENSE WITH THE PRINTING OF THOSE PORTIONS OF THE RECORD TRANSMITTED IN THE ORIGINAL BY THE DISTRICT COURT TO THE COURT OF APPEALS WHICH WERE NOT PRINTED IN THE COURT OF APPEALS	10
APPENDIX A—MEMORANDUM BRIEF IN SUPPORT OF PETITION	
Outline of Argument	11
Argument	14
APPENDIX B—TREASURY DEPARTMENT REGULATION 111, SECTION 29.23 (a) - 15	21

LIST OF AUTHORITIES

Table of Cases

Page

Aetna Insurance Company v. Boon, 95 U S 117, 130; 24 L ed 395, 399 15

Appeal of Backer, 1 BTA 214, 216 15

Bingham's Trust vs. Commissioner of Internal Revenue, 325 U S 365, 89 L ed 1670 ..... 3, 7, 9, 11, 13, 14, 15, 17, 19, 20

Mary Lily Bingham Trust, 2 TC 858 19

Busey v. Deshler Hotel Company, 130 F 2d 187, 142 ALR 563 ..... 12, 18

Cobb v. Commissioner of Internal Revenue, 173 F 2d 711; 338 U S 832, 338 U S 882 7

Kornhauser v. United States, 276 U S 145, 153; 72 L ed 505, 506 15

Lowden v. Hanson, 134 F 2d 348 (CCA, 8, 1943) 11, 16

Massachusetts Bonding & Insurance Company v. Preferred Automobile Insurance Company, 110 F 2d 764 (CCA, 8, 1940) 12, 16

Mayo v. Lakeland Highlands Canning Company, 309 U S 310, 319; 84 L ed 774, 780 ..... 12, 16

Miles v. Van Hagen, 128 P 2d 89, 92, Dist. Court of Appeals, 2d Dist. Calif. 1942 15

Miller v. United States, 294 U S 435, 439-440; 79 L ed 977, 980-981 ..... 12, 18

Public Service Commission v. Wisconsin Telephone Co., 289 U S 68, 71; 77 L ed 1036, 1038 ..... 12, 16

United States v. Cummin's Distillers Corporation, 166 F 2d 17 (CCA, 6, 1948) 11

United States v. Yellow Cab Co., 338 U S 338, 94 L ed 150 ..... 11, 15

Waite v. Macy, 246 U S 606, 609; 62 L ed 892, 895 ..... 12, 18

Webster-Brinkley Company v. Belfield, 166 F. 2d 814 (CCA, 9, 1948) 12, 16

III.

Texts, Etc.

	Page
Nahstoll, I.R.C. Section 23 (a) (2), 46 Michigan Law Review 1015, 1016	8
Trachtman, *Estate Planning*, 1949 Edition Practicing Law Institute, Pages 136 through 151	20
1946 International Revenue Bulletin, T D 5513, May 14, 1946, page 61	8

Statutes, Rules and Regulations

Federal Rules of Civil Procedure, Ruge 52	11, 12, 15, 16
Internal Revenue Code Section 23 (a) (2)	1, 2, 8, 11, 12, 13, 14, 18, 19
Judicial Code, 28 U S C Section 1254 (1)	2
Treasury Department Regulation 111, Section 29.23 (a) - 15 (In full in Appendix B, pp 21 et seq.)	3, 7, 12, 18, 21

No._____.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950

JOSEPH T. LYKES,
Petitioner

vs.

UNITED STATES OF AMERICA
Respondent

(1) PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The Petitioner prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Fifth Circuit entered in the above entitled cause on April 27, 1951 (R 59), reversing a decision and judgment of the United States District Court for the Southern District of Florida (R 44). That decision and judgment directed that the plaintiff should recover for overpayment of certain income taxes, as a result of the plaintiff's right to deduct certain legal expenses paid in connection with a disputed liability for a gift tax deficiency, that right to deduct having been in the taxpayer by virtue of Section 23 (a) (2) of the Internal Revenue Code.

JURISDICTION

The judgment of the Court of Appeals was entered April 27, 1951 (R 59).

The jurisdiction of this Court is invoked under Section 1254 (1) of the Judicial Code, being 28 U S C Section 1254 (1).

OPINIONS BELOW

The Memorandum Opinion of the District Judge, Southern District of Florida, is recorded at 84 F Supp 537.

The opinion of the Court of Appeals is not yet reported.

QUESTIONS PRESENTED

The petitioner contends that the Court of Appeals erred in its apparent determination that any litigation related to gift taxes necessarily means that the expenses of that litigation are not deductible under Section 23 (a) (2) of the Internal Revenue Code. The question, therefore, is: Was the District Court correct in determining that under some circumstances litigation expenses involving gift taxes *are* deductible from income as non-trade or non-business expenses incurred in the "management, conservation, or maintenance of property held for the production of income;" and that such expenses were properly deductible under the facts and circumstances of the instant case?

The Petitioner contends that the District Court's determination was proper, and that the question should be answered in the affirmative.

Perhaps more important to the question of granting certiorari is the question of whether the District Court could properly be reversed by the Court of Appeals in this case, which involves principally, according to the decisions of this Court *(Bingham's Trust vs. Commissioner of Internal Revenue,* 325 U S 365, 370; 89 L ed at 1675), questions of fact.

The Petitioner contends that the Court of Appeals could not within the proper scope of its power of review, reverse the District Court on the record in this case.

STATUTE AND REGULATIONS INVOLVED

The statute involved is Section 23 of the Internal Revenue Code (26 U S C Section 23) as amended by Section 127 (a) of the Revenue Act of 1942, c 619, 56 Stat 798. This Statute reads in part as follows:

"Section 23. Deductions From Gross Income

"In computing net income there shall be allowed as deductions:

"(a) Expenses.—

"(2) Non-Trade or Non-Business Expenses.—

"In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

The Regulations of the Treasury Department here involved (Regulations 111, Section 29.23 (a) -15) have been set out as Appendix B of this Petition.

STATEMENT OF THE CASE

This case was tried in the District Court partly on stipulated facts, and on undisputed testimony and exhibits (R 18-43). On June 8, 1949, the District Judge filed a Memorandum Decision (R 44-49), in lieu of findings of fact and conclusions of law, which decision ordered that judgment be entered in favor of the taxpayer. Judgment was so entered on order of the Court as of November 14, 1949 and filed the following day.

The record, therefore, presents a clear-cut issue as to whether a District Court could find as a fact that litigation expenses which were related to gift tax liabilities could be incurred, either for the production or collection of income, or for "management, conservation or maintenance of property held for the production of income"; and whether there were sufficient facts in this case to support the finding of the District Judge. And it presents the further question of the scope of review by the Court of Appeals of questions of fact found in the decision of a District Judge.

We do not believe that an extended statement of the facts is necessary, inasmuch as the following facts pertinently demonstrate that this case is distinguishable from the ordinary run of cases involving purely personal gifts; and that consequently there was adequate warrant for the District Court's determination that the litigation expenses involved were not proximately caused by a purely personal transaction.

(1) On March 3, 1944, the Commissioner of Internal Revenue notified the Petitioner that a determination of his gift tax liability for 1940 disclosed a deficiency of $145,276.50 (R 45):

(2) The Petitioner-taxpayer engaged K. I. McKay to represent him and to file a petition in the Tax Court for redetermination of such deficiency (R 45). In 1944, the year of the determination of the deficiency, the petitioner paid his attorney $7,263.83 for such legal services (R 46).

(3) Two years later a compromise settlement was reached in the Tax Court case, without trial, on a stipulated gift tax deficiency of $15,612.75, as compared with the $145,276.50 asserted (R 45-46) (R 20-21).

(4) Among the facts and circumstances of the original gifts by this petitioner were the following:

(a) Gifts were made in 1940 of 1000 shares of stock of Lykes Brothers, Inc., a closely held corporation, out of total holdings of the petitioner of approximately 3000 shares (R 36; 44), 250 shares each to his wife, his son and each of his two daughters.

(b) In addition to the motive of love for the gifts, there were additional motives, principally to insure a continuity of ownership and management of the company in accordance with a custom pursued by other members of the Lykes family (R 45); and thus to further fortify the retained interests in the company (R 32). This policy has produced results (R 33, 34, 35, 36).

(c) A substantial interest in Lykes Brothers, Inc., had been retained by the Petitioner through the time of the trial (R 37).

(5) The District Court presumably found in favor of the following contentions of the Petitioner:

(a) Had the asserted gift tax deficiency been successfully enforced against the petitioner it would have substantially destroyed his holdings in Lykes Brothers, Inc., and would have confiscated most of the property held by him for the production of income (R 46).

(b) The payment of attorney's fees of $7,263.83 was made, not as the result of an ordinary contest concerning the valuation of ordinary personal gifts, but it was a payment of legal expenses incurred to forestall the collection by the Government of an assessment of a tax which was so clearly arbitrary and capricious that in fact, it had nothing to do with the gift on which it was based (R 46).

No questions were raised concerning the payment of the tax sought to be refunded. If the payment for the legal services to K. I. McKay is deductible from gross income for the year, as the petitioner claims, then the petitioner is entitled to recover $5,665.78, together with interest, from the respondent (R 45-46).

DECISIONS OF THE DISTRICT COURT AND OF THE COURT OF APPEALS

The District Court found for the petitioner, substantially relying on the facts referred to in the summary above (Memorandum Decision, R 44-49). The District Court also found that the Regulations (Treasury Regulation 111, Section 29.23 (a)-15) insofar as they attempted to prohibit the deduction, were in conflict with the Statute and not effective. In finding for the petitioner the District Court necessarily found as a fact that the litigation expenses paid by the petitioner were "ordinary and necessary expenses paid or incurred during the taxable year for the protection or collection of income, or for the management, conservation

or maintenance of property held for the production of income." The District Court also refused to follow a Sixth Circuit case, *Cobb vs. Commissioner,* 173 F 2d 711, in which certiorari was denied by this Court (338 U S 832, 338 U S 882).

The Court of Appeals for the Fifth Circuit in its decision (R 59-65) determined that Treasury Regulation 111, Section 29.23 (a) -15 (b), was not in conflict with the Statute, but was a reasonable and consistent interpretation thereof, was valid and controlling in this case, and denied the deduction claimed by the petitioner (R 64).

CLAIM BY THE PETITIONER

It is the petitioner's principal claim that the Court of Appeals, in reversing the decision of the District Court, improperly ignored the holding of the Supreme Court of the United States in the case of *Bingham's Trust vs. Commissioner,* 325 U S 365, 89 L ed 1670, to the effect that the lower court's determination of whether or not a particular expense met the conditions of the statutory deduction was principally a question of fact, and that the trier of the fact in this case found for the petitioner *(Bingham case,* 325 U S, 371, 373, 376).

It is also the claim of the petitioner that the decision of the Court of Appeals conflicted in principal with *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 U S 365, 89 L ed 1670, and other cases in this Court there cited.

REASONS FOR GRANTING THE PETITION

The Court of Appeals for the Fifth Circuit has decided an important question of Federal law in a manner which conflicts with a decision of this Court on the same subject.

The application of Section 23 (a) (2) of the Internal Revenue Code is a very important part of federal tax law. It is a broad relief statute, and had as one of the reasons for its approval by Congress, a consideration that the decisions of this Court were very strict interpretations of the business expense section of the same statute *(Nahstoll, I R C Section 23 (a) (2)*, 46 Michigan Law Review 1015, 1016). The Regulations issued by the Treasury Department in interpretation of that statute are presently some fifteen paragraphs in length. Amendment of those Regulations has been forced by other decisions of this Court (T D 5513, May 14, 1946, 1946 *Internal Revenue Bulletin*, page 61).

It is important that this statute and the regulations issued hereunder receive interpretation by this Court, which will adequately guide the courts trying the facts to a determination of their functions under that Statute, and restrict the activities of the Court of Appeals to reversals for obvious errors of law. If this matter is not so determined, then each decision in the courts which are trying the facts will automatically be reversible, as a *de novo* adjudication, in the Court of Appeals, thereby disrupting the business of the Courts and unduly increasing the cost to taxpayers of litigation with their Government.

Furthermore, this case involves, in principle, determinations made by this Court in *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 U S 365, and the decision of the Court of Appeals is, in the Petitioner's opinion, contrary to the principles of that case.

A memorandum brief in support of the taxpayer's position is appended hereto as Appendix A.

CONCLUSION

It is respectfully submitted that this petition for certiorari to review the judgment of the Court of Appeals of the Fifth Circuit should be granted.

Respectfully submitted,

CHESTER H. FERGUSON,

GEORGE W. ERICKSEN,

Address: 215 East Madison Street
(P. O. Box 1531), Tampa, Florida
Attorneys for Petitioner

Dated June 29, 1951.

Of Counsel:
MACFARLANE, FERGUSON,
ALLISON & KELLY
P. O. Box 1531
Tampa, Florida

MOTION TO DISPENSE WITH THE PRINTING OF THOSE PORTIONS OF THE RECORD TRANSMITTED IN THE ORIGINAL BY THE DISTRICT COURT TO THE COURT OF APPEALS WHICH WERE NOT PRINTED IN THE COURT OF APPEALS.

1. Your Petitioner respectfully moves that the Court enter an order dispensing with the printing of those portions of the Record transmitted in the original by the District Court to the Court of Appeals, namely Plaintiff's Exhibits 1 through 8, and as reason therefor makes the following statements.

2. On motion of the United States, to which the Petitioner herein waived objection, the District Court ordered that the Plaintiff's Exhibits 1 through 8, should be transmitted by the Clerk of the District Court to the Court of Appeals in lieu of having same printed as a part of the record (R 54-56).

3. Plaintiff's Exhibits 1 through 8 are principally mathematical calculations of tax and documents supporting the refund claim for the purpose of demonstrating that the Petitioner's suit in the District Court was within the basic framework of the claim filed. In the opinion of the Petitioner, they are not important to the issues brought before this Court.

DATED June 29, 1951.

CHESTER H. FERGUSON,
GEORGE W. ERICKSEN,
Address: 215 Madison Street,
(P. O. Box 1531)
Tampa, Florida
Attorneys for Petitioner

Of Counsel:
MACFARLANE, FERGUSON,
ALLISON & KELLY
P. O. Box 1531,
Tampa, Florida

APPENDIX A

MEMORANDUM BRIEF IN SUPPORT OF PETITION

OUTLINE OF ARGUMENT

I. The Court of Appeals should have considered the District Court's determination as essentially one of fact, and so should have refused to reverse that determination.

1. The applicability of Section 23 (a) (2) is essentially a question of fact.

Bingham's Trust v. Commissioner of Internal Revenue, 325 US 365, 371, 373, 376; 89 L ed 1670.

2. Determinations of fact made by the District Court must be clearly erroneous to be reversed by the Court of Appeals.

Federal Rules of Civil Procedure, Rule 52.

United States v. Yellow Cab Co., 338 US 338, 94 L ed 150.

United States v. Cummin's Distillers Corporation, 166 F 2d 17 (CCA, 6, 1948)

Lowden v. Hanson, 134 F 2d 348 (CCA, 8, 1943).

a. The effect of memorandum decisions is the same as findings of facts and conclusions of law.

Federal Rules of Civil Procedure, Rule 52.

b. In cases where memorandum decisions fail to make sufficient findings, the Court of Appeals either cannot act or must remand.

Mayo v. Lakeland Highlands Canning Co., 309 US, 310, 319; 84 L ed 774, 780.

Massachusetts Bonding & Ins. Co. v. Preferred Automobile Ins. Co.; 110 F 2d 764 (CCA, 8, 1940)

Webster-Brinkley Co. v. Belfield, 166 F 2d 814 (CCA, 9, 1948)

Public Service Commission v. Wisconsin Telephone Co., 289 US 68, 71; 77 L ed 1036, 1038.

3. The Court of Appeals erroneously considered, (a) that the prohibition of the Regulations was absolute rather than exemplary; and (b) that the expense incurred in the instant case was within the prohibition as a matter of law.

a. The Regulations are in terms only exemplary. Regulations 111, Section 29.23 (a)-15.

b. A Regulation with a prohibition as broad as that contended by the Court of Appeals would conflict with the meaning and purpose of Section 23 (a) (2) and so be unauthorized.

c. The Treasury Department cannot by means of Regulations change an essentially factual determination into a legal conclusion.

Miller v. United States, 294 US 435, 439-440; 79 L ed 977; 980-981.

Waite v. Macy, 246 US 606, 609; 62 L ed 892, 895.

Busey v. Deshler Hotel Co., 130 F 2d 187, 142 ALR 563.

4. Conclusion: The District Court made a proper factual determination which should not be upset by the Court of Appeals. In the event that there is any possible factual basis on which the District Court might have found for the Plaintiff, the case should have been remanded by the Court of Appeals for additional findings of fact and conclusions of law, before a final determination by the Court of Appeals.

I. There is no distinction in principal between the case of *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 US 365; 89 L ed 1670, and the instant case.

1. There is no distinction in the application of Section 23 (a) (2) to a trust rather than to an individual.

2. Section 23 (a) (2) treats the individual in the management of his income producing property as a business entity.

3. The distribution of an individual's income producing property is a necessary corollary of his having such property.

a. It should make no difference to the taxability of expenses in the handling of income producing property that an individual chooses to make direct distribution of such property by inter vivos gifts, rather than by the more cumbersome means of testamentary distribution and trusts utilized in the *Bingham* case.

ARGUMENT

I.

The application of Section 23 (a) (2) to a particular factual situation was determined by this Court in *Bingham's Trust v. Commissioner of Internal Revenue*, 325 US 365, 89 L ed 1670, to be essentially a question of fact, on which the determination of the trial court should not be reversed unless clearly erroneous.

> "Ordinary questions of reasonableness and proximity are for the trier of fact, here the Tax Court." (325 US at 370)

> "To exclude from the deduction privilege, expenses which the Tax Court has held to be expenses of management of the trust, on the ground that the trust fund, upon the expiration of the trust, ceased to be 'held for the production of the income' would be *to disregard the Tax Court's findings of fact* and the words of the statute, and would defeat its obvious purpose." (325 US at 373, emphasis supplied)

> "The Tax Court could find as a matter of fact, as it did, that the expenses of contesting the income taxes were a proximate result of the holding of the property for income." (325 US at 376)

It is clear that the Court of Appeals in the instant case reversed the District Court principally on the question of proximity, holding that such expenses were "indirectly, not proximately, related to the management and conservation of the taxpayer's income producing property." (R 64) The Court of Appeals' reliance on the Regulations will be considered briefly later. At this point we consider that it is clear that:

(1) A result may be *indirect*, but nevertheless *proximate*. *Aetna Insurance Co. vs. Boon*, 95 US 117, 130; 24 L ed 395, 399.
Miles vs. Van Hagen, 128 P 2d, 89, 92, District Court of Appeals, Second District, California 1942.
It is sufficient if the expense "is directly connected with *or* proximately results from the conduct of the business" (*Bingham case*, 325 US at 374 emphasis supplied; *Appeal of Backer*, 1 BTA 214, 216, cited *Kornhauser v. United States*, 276 US 145, 153, 72 L ed 505, 506) or from the management or conservation of property held for the production of income.

(2) The determination of the proximate relationship between the expense and the management or conservation of the income producing property is one of fact.

Such determinations of fact must be clearly erroneous in order that the Court of Appeals may reverse. *Federal Rules of Civil Procedure, Rule 52.*

This rule applies to appeals by the Government; and its purpose is to avoid trials *de novo* in the appellate courts. *United States v. Yellow Cab Co.*, 338 US 338, 94 L ed 150.

In the instant case, the District Court did not make specific findings of fact, but wrote a Memorandum Decision ordering judgment for the plaintiff (R 44-49). Such memorandum decisions are "sufficient if the findings of fact and conclusions of law appear therein" *Federal Rules of Civil Procedure, Rule 52.* The Court of Appeals did not consider the District Court's findings, and, in effect, made findings of its own. We cannot,

therefore, determine whether the Court of Appeals found the District Court's findings adequate. If they were not, then the Court of Appeals either: (1) cannot act, because of a failure to present a reviewable question for determination (*Massachusetts Bonding & Ins. Co. v. Preferred Automobile Ins. Co.*, 110 F 2d 764—CCA, 8, 1940), or (2) must remand, so that "any action taken by the Court shall be upon findings of fact and conclusions founded upon the evidence, in accordance with Rule 52 (a) of The Rules of Civil Procedure". *Mayo v. Lakeland Highlands Canning Co.*, 309 US 310, 319, 84 L ed 774, 780; also, *Webster-Brinkley Co. v. Belfield*, 166 F 2d 814 (CCA, 9, 1948); *Public Service Commission v. Wisconsin Telephone Co.*, 289 US 68, 71; 77 L ed 1036, 1038.

Under that rule, which applies as well to inferences from undisputed testimony as to determinations of conflicting evidence (*Lowden v. Hanson*, 134 F. 2d 348, 351—CCA, 8, 1943), it would appear that the Court of Appeals should have either dismissed the appeal or remanded, particularly as its own findings of fact are, in at least one instance, at variance with the record:

Opinion (R 60): "The three children were unmarried and lived with plaintiff. Previous to the gifts, they had taken no active interest in the management of the corporation's affairs. Whether they did so thereafter, does not appear."

Testimony (R 34-35):

"Q. Take your own son, for instance, Joseph T. Lykes, Jr., to whom you made gifts in 1940, did he follow what you thought he would and become identified with the Company?

A He has been, since his release from the Navy, actively identified in the business, and has taken increased responsibility, and functioning as I had hoped he would.

Q Does he also have any official connection with any of the business?

A He is a Director today of both the parent company and the Steamship Company."

This testimony is on the important point of the non-personal aspect of the gift.

We contend that there are *several* bases in the evidence for support of the ultimate fact that the expense in question was proximately related to the management or conservation of income producing property, including: (1) The non-personal aspects of this particular gift, (2) the arbitrary and capricious act of a government agent as an efficient intervening cause between the gift and the legal expenses, (3) the payment of the legal fees, *not* for the successful conclusion of the gift tax case, which occurred two years later, but at the time of the deficiency assertion and for relief against the immediate collection of the tax, and (4) the effect of that arbitrary and capricious act on the income producing property given and on that retained. In order to hold as it did, the Court of Appeals must have decided, contrary to the *Bingham* case, that the proximate relationship between the legal expenses and the management or conservation of income producing property is, in cases involving gifts, a matter of law. The *Bingham* case makes no such exception, and we consider it unwarranted under the statute, the regulations, and the decisions of this Court.

The Court of Appeals considered the regulation interpreting Section 23 (a) (2) as having the force and effect of law. This is so to the extent that the regulation properly *interprets* the law. The first two paragraphs of Regulation 111, Section 29.23 (a)-15 (b) *are* principally interpretive; the rest of the paragraphs of that subsection are principally composed of cited examples of allowed and disallowed deductions, which is particularly true of the phrase relied on by the Court of Appeals (R 62, Note 1, italicized phrase):

> It is settled law in this Court that, while certain examples may be used as guides in interpreting legislation, they cannot be considered as absolute determinations of factual situations, foreclosing a true judicial determination of whether the facts in a particular case do or do not meet the statutory requirement.

> "Undoubtedly, the regulation in terms declares that permanent loss of the use of one hand and one eye shall be deemed to be total permanent disability under an insurance policy such as that issued to petitioner. But the regulation is both inapplicable and invalid.

> * * *

> "It is invalid because not within the authority conferred by the statute . . . It is not, in the sense of the statute, a regulation at all, but legislation. * * * The vice of the regulation, therefore, is that it assumes to convert what in the view of the statute is a question of fact requiring proof into a conclusive presumption which dispenses with proof and precludes dispute. This is beyond administrative power." *Miller v. United States*, 294 US 435, 439-440, 79 L ed 977, 980-981.

To the same effect, *Waite v. Macy*, 246 US 606, 609; 62 L ed 892, 895; and also *Busey v. Deshler Hotel Co.*, 130 F 2d 187, 190; 142 ALR 563.

Conclusion: We respectfully contend that the District Court made a proper factual determination which should not be upset by the Court of Appeals. In the event that there is any possible factual basis on which the District Court might have found for the Plaintiff, the case should have been remanded by the Court of Appeals for additional findings of fact and conclusions of law, before a final determination by the Court of Appeals. The Regulations cannot excuse the abdication by the Courts of appropriate judicial functions. The finding of facts is such a function, and appropriately one for the trial court alone. We should not, as suggested by the alternative views of the Court of Appeals decision, condone either the abdication of that judicial function, nor the undue prolongation of litigation by the equal participation therein of the Court of Appeals.

II

The principles of the *Bingham* case, 325 US 365; 89 L ed 1670, should determine the result in this case. Those principles are antithetical to the Regulations as stringently interpreted by the Court of Appeals.

There is no distinction in Section 23 (a) (2) between its application to a *trust* and to an *individual*. It is in terms applicable to an individual, and only by virtue of Sections 161 and 162 of the Code is it applicable to a trust (*Mary Lily Bingham Trust*, 2 TC 858). Thus, whatever this Court in the *Bingham* case said of the management of a trust is also true of the management of an individual's income-producing fund of property—frequently referred to in ordinary parlance as his "estate."

Consequently, when this Court determines that "Section 23 (a) (2) thus treats the *trust* as an entity

for producing income comparable to a business enterprise" (325 US at 374), it also determines that the *individual's* income-producing "estate" is a comparable entity.

Furthermore, if expenses in connection with the distribution of the trust corpus are deductible as expenses of the management of that income-producing property (325 US at 374, 375), so are expenses in connection with the distribution of the individual's income-producing "estate," regardless of whether he utilizes the mechanism of a trust to that purpose or the simpler mechanism of an inter vivos gift.

Under today's tax laws, the distribution of an individual's income-producing property is often a necessary function of his having such property. He can't take it with him; and inter vivos transfers are a recognized means of conserving the owner's total property. (For example, pages 136 through 151 of Trachtman's *Estate Planning,* 1949 edition, Practicing Law Institute, discuss inter vivos transfers.) The very property which was dealt with in the *Bingham* case was merely the subject matter of the ultimate distribution of an individual's income producing estate. The use of that more cumbersome method of distribution is not a distinction which can logically differentiate it from the instant case.

Conclusion: We respectfully contend that the basic principles applicable to the *Bingham* case should be applied in the instant one, and that, insofar as the present Regulations are inconsistent with that application of those principles, they should be held to be unauthorized.

APPENDIX B

TREASURY REGULATIONS 111

Section 29.23 (a)-15.

Nontrade or Nonbusiness Expenses.—(a) In general.

Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a) (2) only upon the condition that;

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) It is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter incurred in connection therewith are deductible. Similarly, ordinary and necessary expenses incurred in the management, conservation or maintenance of a building de-

voted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23(a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23(a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. Section 24 (a) (5) disallows any amount other-

wise allowable as a deduction (whether under section 23 (a) (2) or otherwise) which is allocable to one or more classes of tax-exempt income, other than interest, and has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts otherwise allowable under that section which are allocable to tax-exempt interest. Thus, any amount allocable to the production or collection of one or more classes of income which is not includible in gross income or to the management, conservation, or maintenance of property held for the production of such income is not deductible under section 28 (a) (2). Nor does section 23 (a) (2) allow any expenses which are disallowed by any of the provisions of chapter 1.

Capital expenditures and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the record of prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

Among expenditures not allowable under section 23 (a) (2) are the following: Commuters' expenses;

expenses of taking special courses or training; expenses for improving personal appearance; the cost of rental of a safe-deposit box for storing jewelry and other personal effects; and expenses such as expenses in seeking employment or in placing oneself in a position to begin rendering personal services for compensation, campaign expenses of a candidate for public office, bar examination fees and other expenses incurred in securing admission to the bar, and corresponding fees and expenses incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions.

Fees for services of investment counsel, custodian fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under section 23 (a) (2) only if (1) they are paid or incurred by the taxpayer for the production or collection of income, or for the management, conservation, or maintenance of investments held by him for the production of income; and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer of such investment.

Ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible even though such property was formerly held by the taxpayer for use as a home.

Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration

expenses, including fiduciaries' fees, and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under this section, notwithstanding that the estate or trust is not engaged in a trade or business, except to the extent that such expenses are allocable to the production or collection of tax-exempt income. But see section 29.162-1 for disallowance of such deductions to an estate where such items are claimed as a deduction under section 812 (b) in computing the net estate subject to the estate tax.

Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring to the ward or minor, or in connection with the management, conservation, or maintenance of property held for the production of income, belonging to the ward or minor are deductible.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deducible expenses. Expenses paid or incurred by an individual in the determination of liabil-

ity for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income.

The deduction of an item otherwise allowable under section 23 (a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 24 (a) (7). Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

(c) The provisions of section 23 (a) (2) are not intended in any way to disallow expenses which would otherwise be allowable under section 23 (a) (1) or the regulations applicable thereto, or under any other

section of the Internal Revenue Code or the regulations applicable thereto. Double deductions are not permitted. Amounts deducted under one provision of the Code cannot again be deducted under any other provision thereof. (Amended by T.D. 5331, approved Feb. 9, 1944, and by T.D. 5513, approved May 14, 1946.)

Office Supreme Court, U. S.
FILED
AUG 14 1951
CHARLES ELMORE CROPLEY

No. 173

In the Supreme Court of the United States.

OCTOBER TERM, 1951

JOSEPH T. LYKES, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

LIBRARY
SUPREME COURT, U. S.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Argument	5
Conclusion	11
Appendix	12

CITATIONS

Cases:

Bingham, Trust of v. *Commissioner*, 325 U. S. 365	5, 7, 8, 9
Brewster v. *Gage*, 280 U. S. 327	5
Cobb v. *Commissioner*, 173 F. 2d 711, certiorari denied, 338 U. S. 832, rehearing denied, 338 U. S. 882	5, 6
Helvering v. *Reynolds*, 313 U. S. 428	5
Murphy Oil Co. v. *Burnet*, 287 U. S. 299	5
United States v. *Gypsum Co.*, 333 U. S. 364	10
United States v. *Yellow Cab Co.*, 338 U. S. 338	10
Willmott v. *Commissioner*, 2 T. C. 321	6

Statute:

Internal Revenue Code:	
Sec. 23 (26 U.S.C. 1946 ed., Sec. 23)	5, 6, 12
Sec. 24 (26 U.S.C. 1946 ed., Sec. 24)	7

Miscellaneous:

H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 74-75 (1942-2 Cum. Bull. 372, 429-430	6
Note, 63 Harv. L. Rev. 357 (1949)	6
S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87-88 (1942-2 Cum. Bull. 504, 570-571)	6
T. D. 5513, 1946-1 Cum. Bull. 61, 62	7
Treasury Regulations 111, Sec. 29.23(a)-15	6, 7, 13

In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 173

JOSEPH T. LYKES, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (R. 58-63) is reported at 188 F. 2d 964. The memorandum opinion of the District Court (R. 44-49) is reported at 84 F. Supp. 537.

JURISDICTION

The judgment of the Court of Appeals (R. 63) was entered on April 27, 1951. The petition for

a writ of certiorari was filed on July 5, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the taxpayer is entitled under Section 23(a)(2) of the Internal Revenue Code to deduct from gross income the amount he paid as attorney's fees in connection with a dispute as to his gift tax liability between himself and the Commissioner of Internal Revenue.

STATUTE AND REGULATIONS INVOLVED

These are set out in the Appendix, *infra,* pp. 12-17.

STATEMENT

The facts as found by the District Court (R. 44-46) are as follows:

The taxpayer is and has been for many years a stockholder in Lykes Brothers, Inc., a family corporation. The stock of the corporation has been closely held throughout its existence and there is not nor has there ever been an open market price for the stock. In the year 1940 taxpayer made gifts of 1,000 shares of stock of the corporation, owned by him, to members of his family, as follows (R. 44):

250 shares to Margaret K. Lykes, his wife
250 shares to Margaret H. Lykes, his daughter
250 shares to Elizabeth L. Lykes, his daughter
250 shares to Joseph T. Lykes, Jr., his son

It appears from the testimony that one of the daughters had reached her majority at the time of the gifts, but the other two children were minors. All of the children made their home with the taxpayer, were unmarried and neither the wife nor the children took any part in the management of the business of Lykes Brothers, Inc., at the time of the gifts. (R. 44.)

The motive for the gifts, as stated in the taxpayer's gift tax return, was love. The taxpayer testified to additional motives, the principal of which was the accepted custom or policy of himself and his brothers to make such gifts to their children to insure continuity of the ownership and management of the company. The evidence shows this custom has been pursued by other members of the Lykes family. (R. 45.)

At the time the gift tax return was filed, taxpayer valued the stock at $120 per share and paid a gift tax thereon in the sum of $13,032.75. The taxpayer testified he took as a guide in determining the value of the stock the only arm's-length transaction of importance during that year of which he had knowledge—the sale of several hundred shares by an executive (not a member of the Lykes family) to other executives of the company. He testified he also took into consideration the hazards then confronting the business and reached the conclusion that the market value established

by the sale represented the fair value of the stock at the time. (R. 45.)

On March 3, 1944, the Commissioner of Internal Revenue formally notified the taxpayer that a determination of his gift tax liability for 1940 disclosed a deficiency of $145,276.50 and a deficiency in that amount was assessed against taxpayer. He also was notified of his right to petition the Tax Court for a redetermination of such deficiency liability. (R. 45.)

The taxpayer engaged K. I. McKay to represent him in this matter and a petition for redetermination of the liability was filed with the Tax Court. After taxpayer's attorney had prepared and filed such petition and prepared his case for trial, a compromise settlement was reached and the Tax Court, pursuant to stipulation of the parties, found a deficiency in taxpayer's gift tax return in the sum of $15,612.75, which was promptly paid. The taxpayer paid his attorney $7,263.83 in the year 1944 for services in this matter. (R. 45-46.)

The taxpayer did not deduct the $7,263.83 in his income tax return for 1944, but later claimed the right to deduct it. (R. 3-4.) The Commissioner disallowed such deduction (R. 14), but the District Court entered a decision in favor of the taxpayer (R. 49). The Court of Appeals reversed the judgment of the District Court. (R. 63.)

ARGUMENT

Section 23(a)(2) of the Internal Revenue Code, Appendix, *infra*, pp. 12-13, provides for the deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." The Court of Appeals held that the legal fees paid in connection with the taxpayer's contest of a gift tax deficiency did not come within the purview of this statutory provision and hence are not deductible. This decision is in harmony with the only other decision involving the same question (*Cobb* v. *Commissioner*, 173 F. 2d 711 (C.A. 6th), certiorari denied, 338 U. S. 832,[1] rehearing denied, 338 U. S. 882) and is plainly correct on both the statutory language and its purpose. It is expressly directed by the Treasury Regulations[2] and is consonant with the decision of this Court in *Trust of Bingham* v. *Commissioner*, 325 U. S. 365.

1. Not every non-business expense is deductible under Section 23(a)(2). The test is whether the expense for which a deduction is sought is one

[1] Mr. Justice Black and Mr. Justice Jackson were of the opinion that certiorari should be granted.

[2] The regulation states a reasonable rule, and it should be sustained as a permissible application of the statute, even though it might be thought, contrary to our view, that a converse rule would also be possible. Cf. *Helvering* v. *Reynolds*, 313 U. S. 428; *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299; *Brewster* v. *Gage*, 280 U. S. 327.

which is proximately related to the production or collection of income or to the care or conservation of property held to produce income. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 74-75 (1942-2 Cum. Bull. 372, 429-430); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87-88 (1942-2 Cum. Bull. 504, 570-571); Section 29.23(a)-15(a) of Treasury Regulations 111, Appendix, *infra*, pp. 13-15. But expenses incurred in contesting gift tax liability bear no such relation to the production of income nor to the management or conservation of income-producing property. A gift is by its very nature personal. The gratuitous disposition of property can hardly be termed production of income.[3] Moreover, it seems clear that the profitless separation from the taxpayer of some of his property cannot be even remotely considered to be an integral part of the management or conservation of one's estate, for it is not an activity calculated to enlarge one's estate but rather to diminish it.[4] Thus, the expenses here involved were "personal" or "family expenses" expressly made nondeductible by Sec-

---

[3] If the gratuitous disposition of property were an act designed to produce income, then the value of the gift would be a deductible expense under Section 23(a)(2) of the Code.

[4] In *Cobb* v. *Commissioner*, *supra*, it was argued that the enforcement of a deficiency for gift taxes in a case of this type would constitute a lien on property held by the donor for the production of income. However, the acceptance of such a theory would lead to the allowance of expenses in defending any action, such as one for personal injuries, that might result in a judgment lien on the taxpayer's income-producing property. See *Willmott* v. *Commissioner*, 2 T. C. 321, and Note, 63 Harv. L. Rev. 357 (1949).

tion 24(a)(1) of the Internal Revenue Code, Appendix, *infra*, p. 13.

Section 29.23(a)-15(b) of Treasury Regulations 111, Appendix, *infra*, p. 17, expressly states in part—

> expenses paid or incurred by an individual in the determination of gift tax liability, * * * are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability * * *

This was promulgated as a result of the decision in *Trust of Bingham* v. *Commissioner*, 325 U. S. 365. See T. D. 5513, 1946-1 Cum. Bull. 61, 62. The taxpayer contends (Br. 19-20), however, that instead of following the principles announced in the *Bingham* case, the Treasury has rejected those principles. This view is erroneous. In the *Bingham* case expenses attendant upon the distribution to beneficiaries of trust principal and income were held deductible only because they were "expenses of a function of 'management' of the trust property." (325 U. S. 375.) They were such only because "the duties of the trustees" included a fiduciary obligation "to distribute the income and the principal so held from time to time, and the remainder of the principal at the expiration of the trust. Performance of each of these duties [was] an integral part of carrying out the trust enter-

prise." But here the taxpayer was under no obligation whatever to make gifts to his children. The act of donation was not an act of "management, conservation or maintenance of property held for the production of income." In fact, taxpayer's reliance on the *Bingham* decision particularly emphasizes the correctness of the position of the Court of Appeals. Taxpayer argues (Br. 19) that "whatever this Court in the *Bingham* case said of the management of a trust is also true of the management of an individual's income-producing fund of property." However, as stated *supra*, in the *Bingham* trust a fiduciary obligation to the beneficiaries was being carried out; here only a man's obligation to himself was being effectuated. Thus the personal nature of this expense is further illustrated, and the Court of Appeals correctly refused to accept the impractical concept that giving away property produced income to the taxpayer.

2. It is further argued (Br. 14-19) that the question of the proximate relationship between the expense and the management of the income-producing property is essentially one of fact, and that since there are several evidentiary facts supporting the conclusion that the expense was proximately related to the management of conservation of income-producing property, the case should have been remanded by the Court of Appeals for additional findings of fact and conclusions of law before a final determination. Initially this argument mis-

conceives the nature of the question here involved. The evidentiary facts dispositive of this case are undisputed. The nature of the transferred property, the fact of the gift and all other relevant attendant circumstances were all found by the District Court and have not been and are not challenged. The Court of Appeals decided a question of law. Indeed, the case that the taxpayer relies on (Br. 14) for the proposition that his case involves a question of fact (*Trust of Bingham* v. *Commissioner*, *supra*) explicitly states that this type of question is one of law (325 U. S. at 371):

> The questions whether, on the facts found, the expenses in question are nondeductible, either because they were not to produce income or because they were related to the management of property which was not held for the production of income, turn in this case on the meaning of the words of § 23(a)(2), "property held for the production of income." They are therefore questions of law, decision of which is unembarrassed by any disputed question of fact or any necessity to draw an inference of fact from the basic findings.

Even assuming, *arguendo*,[5] that a question of fact is presented in this case, it seems manifest that the taxpayer's position is untenable. The scope of review by the Court of Appeals in that situation

[5] If the result in this type of case depends on a resolution of the particular facts involved, then it is plainly not a proper case for the granting of a petition for certiorari.

would be whether or not the finding by the trial court was clearly erroneous. Presumably the taxpayer argues that this means that if there is any basis for supporting the conclusion of the lower court, then the appellate court may not reverse. However, as this Court stated in *United States* v. *Gypsum Co.*, 333 U.S. 364, 395:

> A finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.

See also *United States* v. *Yellow Cab Co.*, 338 U.S. 338, 340-342. Thus the Court of Appeals in reversing the trial court was acting clearly within the proper scope of judicial review.

CONCLUSION

The decision of the court below is not in conflict with any other decision. It is a correct interpretation of the taxing statute and is required by the Treasury Regulations. It is, therefore, respectfully submitted that the petition for a writ of certiorari should be denied.

PHILIP B. PERLMAN,
Solicitor General.

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
GEORGE D. WEBSTER,
Special Assistants to the Attorney General.

AUGUST, 1951.

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he had no equity.

* * * * * * *

(2) *Non-trade or non-business Expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance

of property held for the production of income.

* * * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

* * *

* * * * * *

(26 U.S.C. 1946 ed., Sec. 24.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(a)-15. *Nontrade or Nonbusiness Expenses:*

(a) *In general.*—Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a)(2) only upon the condition that:

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23(a)(2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible as income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter incurred in connection therewith are deductible. Similarly, ordinary and necessary expenses incurred in the management, conservation or maintenance of a building devoted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purposes for which the property in question was acquired. Expenses incurred in managing, conserving or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to

minimize a loss with respect thereto. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23(a)(2) must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a responsible and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) [as amended by T. D. 5513, 1946-1 Cum. Bul. 61, 62] Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23(a)(1)(A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. * * * Nor does section 23(a)(2) allow any expenses which are disallowed by any of the provisions of chapter 1. Capital expenditures, and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collec-

tion of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the record of prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

* * * * *

Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of

income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income.

* * * * *

☆ U. S. GOVERNMENT PRINTING OFFICE: 1951 O—947933

LIBRARY
SUPREME COURT, U.S.

Office-Supreme Court, U. S.
FILED
NOV 28 1951
CHARLES ELMORE CROPLEY

No. 173

In the Supreme Court of the United States

OCTOBER TERM, 1951

JOSEPH T. LYKES, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Summary of argument	3
Argument:	
I. The claimed deduction is not allowable under Section 23(a)(2) of the Internal Revenue Code	8
A. The provisions of Section 23(a)(2) and their legislative history	10
B. Gift expenses are not within the purview of Section 23(a)(2)	13
C. The decision below is in accord with the decisions of this Court	23
II. The Treasury Regulation barring the claimed deduction is valid	28
III. The court below did not exceed its reviewing powers in reversing the District Court	33
Conclusion	36
Appendix A	37
Appendix B	43

CITATIONS

Cases:

Bagley v. *Commissioner*, 8 T.C. 130	27
Bingham's Trust v. *Commissioner*, 325 U. S. 365,	6, 7, 12, 14, 18, 24, 25-26, 27, 29, 32, 34, 35
Boehm v. *Commissioner*, 326 U. S. 287	19, 21, 32
Brewster v. *Gage*, 280 U. S. 327	30
Cobb v. *Commissioner*, 10 T.C. 380, affirmed, 173 F. 2d 711, certiorari denied, 338 U. S. 832, rehearing denied, 338 U. S. 882	10, 14, 27-28, 33
Commissioner v. *Estate of Bedford*, 325 U. S. 283	35
Commissioner v. *Flowers*, 326 U. S. 465	15, 16, 19, 23, 32
Commissioner v. *Heide*, 165 F. 2d 699	27
Commissioner v. *Heininger*, 320 U. S. 467	16, 18, 23, 33, 35
Commissioner v. *Jacobson*, 336 U. S. 28	19
Commissioner v. *Josephs*, 168 F. 2d 233	27
Commissioner v. *South Texas Co.*, 333 U. S. 496	30, 31
Deputy v. *duPont*, 308 U. S. 488	15, 16, 18, 19, 20, 22, 23
Dobson v. *Commissioner*, 320 U. S. 489	35
Fawcus Machine Co. v. *United States*, 282 U. S. 375	30

Cases—Continued

	Page
General Utilities Co. v. *Helvering*, 296 U. S. 200	36
Guggenheim v. *Rasquin*, 312 U. S. 254	20
Helvering v. *Reynolds Co.*, 306 U. S. 110	30
Helvering v. *Wilshire Oil Co.*, 308 U. S. 90	30
Helvering v. *Winmill*, 305 U. S. 79	32
Higgins v. *Commissioner*, 312 U. S. 212	11, 16
Hormel v. *Helvering*, 312 U. S. 552	36
Interstate Transit Lines v. *Commissioner*, 319 U. S. 590,	15, 19, 22, 23
Kornhauser v. *United States*, 276 U. S. 145	16, 18, 23, 33
McDonald v. *Commissioner*, 323 U. S. 57	11, 14, 19, 23, 24, 35
Morrissey v. *Commissioner*, 296 U. S. 344	30, 31
New Colonial Co. v. *Helvering*, 292 U. S. 435	19
Rothensies v. *Electric Battery Co.*, 329 U. S. 296	19
Spiegel, Estate of, v. *Commissioner*, 335 U. S. 701	36
United States v. *Gypsum Co.*, 333 U. S. 364	35
United States v. *Yellow Cab Co.*, 338 U. S. 338	35
Welch v. *Helvering*, 290 U. S. 111	18

Statute:

Internal Revenue Code:	
Sec. 11 (26 U.S.C. 1946 ed., Sec. 11)	32
Sec. 22 (26 U.S.C. 1946 ed., Sec. 22)	13
Sec. 23 (26 U.S.C. 1946 ed., Sec. 23),	3, 4, 5, 6, 8, 9, 10, 11, 13, 14, 15, 16, 17, 18, 19, 23, 24, 31, 33, 37
Sec. 24 (26 U.S.C. 1946 ed., Sec. 24)	5, 10, 15, 19, 37
Sec. 62 (26 U.S.C. 1946 ed., Sec. 62)	28
Sec. 111 (26 U.S.C. 1946 ed., Sec. 111)	13
Sec. 113 (26 U.S.C. 1946 ed., Sec. 113)	18
Sec. 1000 (26 U.S.C. 1946 ed., Sec. 1000)	32
Sec. 1004 (26 U.S.C. 1946 ed., Sec. 1004)	18
Sec. 1009 (26 U.S.C. 1946 ed., Sec. 1009)	14
Sec. 3791 (26 U.S.C. 1946 ed., Sec. 3791)	28
Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 121(a)	11
Revenue Act of 1948, c. 168, 62 Stat. 110	32
Revenue Act of 1950, P. L. 814, 81st Cong., 2d Sess.	32
Revenue Act of 1951, P. L. 183, 82nd Cong., 1st Sess.	32

Miscellaneous:

63 Harv. L. Rev. 357 (1949)	33
H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74-75 (1942-2 Cum. Bull. 372, 410, 429-430)	12, 16, 43
Rule 52, Federal Rules of Civil Procedure	35
S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87-88 (1942-2 Cum. Bull. 504, 570-571)	2, 46
T. D. 5513, 1946-1 Cum. Bull. 61	29, 40
Treasury Regulations 111, Sec. 29.23(a)-15	9, 12, 16, 28, 29, 38

In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 173

JOSEPH T. LYKES, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The memorandum opinion of the District Court (R. 26-31) is reported at 84 F. Supp. 537. The opinion of the Court of Appeals (R. 33-38) is reported at 188 F. 2d 964.

JURISDICTION

The judgment of the Court of Appeals was entered April 27, 1951. (R. 38.) The petition for a writ of certiorari was filed July 5, 1951, and was granted October 8, 1951 (R. 40). The jurisdiction of this Court rests on 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether expenses incurred by a donor of property in litigating a deficiency in gift tax are deductible from his gross income, in the computation of income tax, under Section 23(a)(2) of the Internal Revenue Code and the applicable Treasury Regulations.

STATUTE AND REGULATIONS INVOLVED

These are set forth in Appendix A, *infra*, pp. 37 to 43.

STATEMENT

The facts as stipulated (R. 10-12) and found by the District Court (R. 26-28) may be summarized as follows:

Taxpayer is a stockholder in Lykes Brothers, Inc., a family corporation whose stock has been closely held throughout its existence. In 1940, taxpayer made gifts aggregating 1,000 shares of the stock to his wife, son, and two daughters, giving to each 250 shares. He filed a gift tax return in which he stated that the motive for his gifts was love, valued the stock at $120 per share, and paid a gift tax of $13,032.75. In 1944 the Commissioner of Internal Revenue formally notified taxpayer of a gift tax deficiency for 1940 in the amount of $145,276.50, which deficiency was based upon a valuation of the stock at $915.50 per share. Taxpayer engaged an attorney, who prepared and filed with the Tax Court a petition for redetermination of the gift tax deficiency. In 1946, a compromise

settlement was reached before trial and, pursuant to stipulation of the parties, the Tax Court found a deficiency in gift tax in the sum of $15,612.75, which was promptly paid. Taxpayer paid his attorney $7,263.83 in 1944 for legal services in this matter. (R. 10-12, 26-28.)

In his income tax return for 1944, taxpayer did not deduct the attorney's fee from his gross income. Thereafter he filed a claim for refund on the ground that the fee was deductible under Section 23(a)(2) of the Internal Revenue Code. (R. 4A-4B.) The claim was denied by the Commissioner (R. 7), and taxpayer sued for refund.

The District Court held that the claimed deduction was allowable under Section 23(a)(2), and that Section 29.23(a)-15(b) of Treasury Regulations 111, which prohibited the deduction, was unauthorized and invalid. (R. 26-31.) The Court of Appeals reversed. (R. 33-38.)

SUMMARY OF ARGUMENT

I

Section 23(a)(2) of the Internal Revenue Code authorizes the deduction from gross income of a limited class of non-business expenses, namely, those incurred "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." It was added to the Code for the restricted purpose of affording relief to taxpayers

whose non-business activities produced taxable income, but whose expenses connected with such activities were not deductible as "business" expenses under Section 23(a)(1).

The expense here in question, consisting of the payment of an attorney's fee for services in contesting an asserted deficiency in gift tax, was directly connected with, and resulted solely from, a gift of stock. A gift is a personal transaction having no relation to any of the activities specified in Section 23(a)(2). Expenses connected with the gift are not expenses incurred "for the production or collection of income," within the meaning of Section 23(a)(2); since a gift is a non-taxable event which produces no gain or loss for income tax purposes. Nor are they expenses incurred "for the management, conservation, or maintenance of property held for the production of income," within the intent of that section, since they are incurred in the process of transferring ownership of the property and its future income from one taxpayer (the donor) to another (the donee). A taxpayer does not manage or conserve his income-producing property, nor does he hold it for the production of income, by giving it away. On the contrary, the effect of the gift is to diminish the taxpayer's property and, correspondingly, his income from property. That the expense was incurred in litigation with the Government does not alter the nature of the expense. It is immaterial

whether the donor's expenses connected with the gift are incurred for services in preparing the necessary gift documents or gift tax returns, or in resisting claims of third persons who might attack the gift, or, as here, in resisting a claim of the Government under the gift tax statute. Assuming that such expenses are ordinary and necessary in the sense that they are normal and reasonable in amount, they are ordinary and necessary personal expenses connected with a gift, the deduction of which is barred by Section 24 (a) (1), rather than permitted by Section 23 (a) (2).

That the donor may be required to liquidate some of his income-producing property in order to pay a gift tax deficiency does not serve to transform an expense incurred in contesting the deficiency from one relating to a gift into one incurred "for the management, conservation, or maintenance of property held for the production of income." To treat it as deductible for that reason would sanction the deduction of expenses incurred in defending any personal law suit which might result in a judgment lien against the taxpayer's income-producing property, and defeat the statutory ban against personal expense deductions. Expenses of gift tax litigation would not be deductible "business" expenses under Section 23(a)(1) merely because the gift tax might become a lien on the donor's business property. By the same token, such expenses are not deductible under Section 23(a)(2) merely

because the gift tax might become a lien on his non-business income-producing property.

Nothing in the opinion of this Court in *Bingham's Trust* v. *Commissioner*, 325 U.S. 365, upon which the District Court relied, supports the deduction of expenses of litigating gift tax liability. In that case administration expenses of a trust, relating to the distribution of the trust property, including expenses of litigating income tax liability, were held deductible on the ground that they were incurred by the trustees in discharge of their fiduciary duties and hence were proximately related to the "management" of the trust enterprise. A voluntary gift, as distinguished from a distribution by trustees, is not an act of management. In the only other case involving the question here presented, both the Tax Court and the Court of Appeals, in soundly reasoned opinions concurred in by the court below, properly distinguished the *Bingham* case and denied the deduction.

Taxpayer's contention that the gift tax deficiency was arbitrarily asserted by the Government has no support in the record or in the findings of the District Court. But even if the deficiency had been asserted without a reasonable basis, that would not convert the expense from one connected with the gift into one incurred for the purposes designated in Section 23(a)(2).

The taxpayer's contention that his motive for transferring the stock to his wife and children was

not only love but also to maintain the family interest in the corporation does not support the deduction of the expense. Gifts to members of the taxpayer's family may maintain the family interest, but they decrease the taxpayer's own interest. Even assuming that giving away one-third of one's property is an ordinary and usual method of producing income and conserving the remainder, the argument proves too much, since it leads to the absurd result that the gift itself is a deductible expense.

II

The applicable Treasury Regulation, promulgated after the *Bingham* decision, explicitly prohibits deduction of expenses incurred in the determination of gift tax liability. The regulation is in harmony with the statute and its legislative history. Even assuming that the statute could reasonably be construed as authorizing the claimed deduction, the interpretation placed upon it by the Treasury —the agency charged with its administration and authorized to promulgate interpretive regulations —is also a permissible one; and this Court has repeatedly held that a Treasury Regulation must be sustained unless plainly inconsistent with the statute. Moreover, the applicable regulation must be deemed to have received implied legislative approval by virtue of substantial re-enactments of the statutory provision to which it is addressed.

III

The court below did not exceed its powers of review in reversing the District Court. This case presents a reviewable question of law turning on the meaning and intent of Section 23 (a) (2). Furthermore, the District Court did not rest its decision on any factual determination that the expense was proximately related to the production of income or to the management of income-producing property; it allowed the deduction because of its conviction that such result was required as a matter of law, and that the Treasury Regulation barring the deduction was invalid. Even if this case were viewed as presenting only a question of fact, the District Court's decision is clearly erroneous and was properly reversed, since the undisputed fact that the expense was incurred in gift tax litigation precludes any finding that it satisfied the conditions of the statute. No useful purpose would be served by remanding the case to the District Court, for that court could make no further findings which could bring the expense within the class allowed by the statute.

ARGUMENT

I

The Claimed Deduction Is Not Allowable under Section 23(a)(2) of the Internal Revenue Code

This case turns on the construction of Section 23(a)(2) of the Internal Revenue Code (Appendix A, *infra*, p. 37) which authorizes the deduction

from gross income, in the computation of income tax, of ordinary and necessary expenses incurred "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." The facts dispositive of the case are not in dispute. The claimed deduction is for an expenditure made by taxpayer in 1944 for legal services in contesting a gift tax deficiency asserted by the Government. The gift was of stock in a closely held family corporation, and was made to members of the taxpayer's family. The gift tax litigation arose because of different valuations placed upon the stock by the taxpayer and the Commissioner, and was settled before trial at a compromise figure. (R. 10-12, 26-28, 34.)

The Commissioner disallowed the claimed deduction, in keeping with the applicable Treasury Regulation (Section 29.23(a)-15(b), Appendix A, *infra*, pp. 40-43), which provides that "expenses paid or incurred by an individual in the determination of gift tax liability . . . . are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability." The District Court made no finding that the expense in question was incurred for or related to any of the purposes specified in Section 23(a)(2).[1] It held that to construe that

[1] While it referred to certain testimony and contentions of the taxpayer, it made no findings with respect to them, nor did it attempt to appraise their relevancy or significance. (R. 27-28.)

section as not embracing expenses of gift tax litigation would be a denial of "justice," and that the Treasury Regulation prohibiting the deduction of such expenses was unauthorized. (R. 30-31.) The Court of Appeals disagreed. Following the decision of the Tax Court and the Court of Appeals in *Cobb* v. *Commissioner*, 10 T. C. 380, affirmed, 173 F. 2d 711 (C.A. 6th), certiorari denied, 338 U. S. 832, rehearing denied, 338 U. S. 882, it held that expenses incurred in litigating gift tax liability do not fall within the purview of Section 23(a)(2), and that in any event the regulation must be sustained as a reasonable and permissible interpretation of that section. (R. 35-38.) We submit that the Treasury Regulation and the decision of the Court of Appeals sustaining it are fully in accord with the applicable statutory provisions, their legislative history, and the decisions of this Court.

A. *The provisions of Section 23(a)(2) and their legislative history*

The income taxing statute draws a distinction between expenses relating to personal transactions, and those related to income-producing activities. Section 24(a)(1) of the Internal Revenue Code (Appendix A, *infra*, p. 38), provides that "In computing net income no deduction shall in any case be allowed in respect of . . . Personal . . . expenses." Section 23(a)(1)(A) (Appendix A, *infra*, p. 37), authorizes the deduction of expenses

incurred "in carrying on any trade or business," provided they are ordinary and necessary. Section 23(a)(2) authorizes the deduction of a limited class of "non-business expenses," namely, those incurred "for the production or collection of income" or "for the management, conservation, or maintenance of property held for the production of income," provided they are also ordinary and necessary.

Section 23(a)(2) was added to the Code by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, for the restricted purpose of affording relief in situations like that presented in *Higgins* v. *Commissioner*, 312 U.S. 212, wherein this Court held that an investor in income-producing securities was not carrying on a "business" and hence was not entitled under Section 23(a)(1) to deduct expenses incurred in managing his investments and collecting the income therefrom. In referring to the legislative background of Section 23(a)(2), this Court stated in *McDonald* v. *Commissioner*, 323 U.S. 57, 61-62:

> This amendment was proposed by the Treasury (1 Hearings before Committee on Ways and Means, Revenue Revision, 1942, 77th Cong., 2d Sess., p. 88) to afford relief for a specifically defined inequitable situation which had become manifest by the decision of the Court in *Higgins* v. *Commissioner*, 312 U.S. 212. In that case this Court held that by previous enactments Congress had made no pro-

> vision for allowable deductions from profitable transactions not covered by the statutory concept of "business" income. * * * Congress adopted the Treasury proposal for the restricted purpose which originated it. * * * The amendment of 1942 merely enlarged the category of incomes with reference to which expenses were deductible.

Attached to this brief as Appendix B, *infra*, pp. 43-46, is a copy of the House Committee Report which accompanied the Revenue Bill of 1942. It is clear from the Report that Section 23(a)(2) was designed to place expenses incurred in producing non-business income on a parity with those incurred in producing business income, since both types of income were subject to the income tax. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74-75 (1942-2 Cum. Bull. 372, 410, 429-430); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87-88 (1942-2 Cum. Bull. 504, 570-571. "The effect of § 23(a)(2) was to provide for a class of non-business deductions coextensive with the business deductions allowed by § 23 (a) (1), except for the fact that, since they were not incurred in connection with a business, the section made it necessary that they be incurred for the production of income or in the management or conservation of property held for the production of income." *Bingham's Trust* v. *Commissioner*, 325 U.S. 365, 374. See also Section 29.23 (a)-15(a) of Treasury Regulations 111 (Appendix A, *infra*, pp. 38-40).

B. *Gift expenses are not within the purview of Section 23(a)(2)*

Expenses incurred by a donor in connection with a gift of income-producing property, including expenses of litigating gift tax liability, do not fall within the limited class of non-business expenses allowable as deductions from gross income under Section 23(a)(2). To hold otherwise would do violence to the Congressional intent revealed by the language of the statute and its legislative history.

Expenses connected with a gift of property are not incurred "for the production or collection of income," within the meaning of Section 23(a)(2), since a gift has nothing to do with the production or collection of income. The purpose and effect of a gratuitous transfer of income-producing property are to change the ownership of the property and the income subsequently produced by it, a transaction which results in no gain or loss for income tax purposes.[2] And far from constituting expenses incurred "for the management, conservation, or maintenance of property held for the production of income," within the meaning of that section, expenses connected with a gift of income-producing property are incurred in the process of transferring ownership and management of the

[2] A gift of property is not a taxable event for income tax purposes. The income from the property is thereafter taxable to the donee (Section 22(b)(3)), and the donee acquires the donor's "basis" for determining gain or loss on a later sale or exchange of property (Sections 111, 113(a)(2) and (b)). Deduction of the gift taxes is expressly barred by Section 23(c)(1)(D).

property from one taxpayer (the donor) to another (the donee). A taxpayer obviously does not "manage" or "conserve" his property by giving it away.[3] On the contrary, the gift operates to diminish the amount of "property held for the production of income" by the donor and, correspondingly, the amount of "income" from such property.[4] In short, expenses which result from a gift of property (including expenses of litigating gift

---

[3] There can be no quarrel with the taxpayer's observation (Br. 30-31) that gifts *inter vivos* are a recognized means of distributing ones estate. But such a distribution is not, as the taxpayer assumes (Br. 29-30), the kind of "distribution" with which this Court was dealing in the *Bingham* case. Estate planning is by no means synonymous with the management of a person's own estate, or (as in the *Bingham* case) of a trust estate. It deals, rather, with the distribution of estates and the income therefrom in a way which will minimize tax liabilities and the other hardships or inconveniences which might result from the continued ownership of large amounts of property by an individual. When gifts are made within the family group, there may be an ultimate saving of taxes to the family as a unit. But neither the impact of the income tax law nor the deductions permitted by Section 23(a)(2) is based on the family unit; they apply to the taxpayer individually (See *Cobb* v. *Commissioner*, 173 F. 2d at 715). A gift of property, however wise from an estate point of view, disrupts the very holding of property by the taxpayer, which is the basis for a deductible expense. Before the gift, the property was held for the production of income by the donor as an individual; after the gift, it is held by someone else.

[4] Conversely, the donee (who is liable for the gift tax to the extent of the value of the gift, under Code Section 1009) would not be entitled to deduct the expense of litigating the gift tax, since the expense would be incurred in the course of obtaining the property, not for the management or conservation of property already "held" by him for the production of income. Cf. *McDonald* v. *Commissioner*, *supra*, wherein this Court held (p. 60) that the campaign expenses of a judge seeking election "were not expenses incurred in being a judge but in trying to be a judge", and hence (p. 62) "were not incurred in 'carrying on' his 'business' of judging."

tax liability) can not be deemed expenses proximately related either to the production of income or the management of income-producing property within the meaning and intent of Section 23(a)(2). They are in the nature of personal expenses attributable to the donor's act of giving away his property, the deduction of which is proscribed by Section 24(a)(1). Cf. *Commissioner* v. *Flowers*, 326 U.S. 465. It is the "origin and nature" of the expense which is determinative of the right to the deduction. *Deputy* v. *duPont*, 308 U.S. 488, 494; *Interstate Trunsit Lines* v. *Commissioner*, 319 U.S. 590, 594.[5]

The circumstance that the expense in question was incurred in litigation with the Government does not serve to transform it from a non-deductible expense into a deductible one. The crucial fact remains that the litigation, and the expenses connected with it, proximately resulted from, and were directly connected with, a gift.

It is immaterial whether the donor's expenditures in connection with the gift are for services in preparing the necessary gift documents and

---

[5] In the *Interstate Transit Lines* case this Court stated (p. 594) that—

> The mere fact that the expense was incurred under contractual obligation does not of course make it the equivalent of a rightful deduction under § 23 (a). That subsection limits permitted deductions to those paid or incurred "in carrying on any trade or business." The origin and nature, and not the legal form, of the expense sought to be deducted determines the applicability of the words of § 23 (a).

gift tax returns, or in resisting claims of third persons who may attack the gift, or, as here, in resisting gift tax liability asserted by the Government under the gift tax statute. Granting that such expenditures are ordinary and necessary in the sense that they are normal and are reasonable in amount,[6] they are ordinary and necessary expenses falling outside the ambit of Section 23(a)(2). Cf. *Commissioner* v. *Flowers, supra; Higgins* v. *Commissioner, supra.* The issue here is not whether the expense satifies the statutory requirement that it be an ordinary and necessary one, but whether it falls within the limited class of ordinary and necessary non-business expenses which Congress has authorized as deductions. The question of whether a particular expense is ordinary and necessary is not reached unless it can be shown that the expense meets the basic statutory requirement that it is incurred "for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income." See Section 29.23(a)-15(a) of Treasury Regulations 111. H. Rep. No. 2333, *supra*, pp. 74-75. Since the expense in question was directly connected with and resulted solely from a gift of property, this basic requirement has not here been met.

---

[6] Cf. *Commissioner* v. *Heininger*, 320 U.S. 467; *Welch* v. *Helvering*, 290 U.S. 111, 114; *Deputy* v. *duPont*, *supra*, pp. 494, 495; *Kornhauser* v. *United States*, 276 U.S. 145, 153. The Commissioner concedes, as he did below (R. 28), that the expenditure in question was reasonable in amount.

The taxpayer argues that the expense is deductible because it was incurred to protect income producing property from the asserted gift tax deficiency (Br. 24-25, 27, 32). But the circumstance that a taxpayer may be required to use property or funds (whether or not income-producing) to satisfy a claim against him affords no basis for treating expenses incurred in resisting the claim (successfully or unsuccessfully) as expenses incurred "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income," as that language is used in Section 23(a)(2). To treat the expense as deductible for that reason would require the allowance of expenses incurred in defending virtually any claim or law suit, including those of a personal nature (e.g., for personal injuries, or for residential rent or taxes), that might result in a judgment lien on the taxpayer's property.[7] This would defeat the legislative mandate that no deductions for personal expenses shall be allowed. Clearly a taxpayer engaged in a business would not be entitled to deduct as a "business" expense allowable under Section 23(a)(1) expenses incurred in gift tax litigation merely because the gift tax might become a lien on his business property. The expenses would

[7] Moreover, the deductibility of the expense would turn on how much property the taxpayer has available for satisfaction of the claim, and what portion of it if any consists of income-producing property, considerations having no bearing upon the nature of the expense.

plainly lack the requisite relationship to the carrying on of the business. *Kornhauser* v. *United States, supra; Commissioner* v. *Heininger, supra; Deputy* v. *duPont, supra.*[8] By the same token, the expense is not deductible under Section 23(a)(2), which is in *pari materia* with Section 23(a)(1) (*Bingham's Trust* v. *Commissioner, supra,* pp. 373, 374), merely because the gift tax might become a lien on his non-business income-producing property, since it is not proximately related to any activity ("business") of producing income or of managing and conserving property for the production of income. As the court below observed (R. 37) "such expense is not one directly incurred in managing or conserving such property, nor is it a proximate result of holding property for the production of income, any more than fees or expenses incurred in any other type of personal, as distinguished from business, litigation (e.g., an ordinary tort action) which might result in a lien upon the taxpayer's income-producing property."

The provisions of Section 23(a)(2) must of course be examined in the light of the "now familiar rule that an income tax deduction is a matter of legislative grace and that the burden of

[8] The only deductions which Congress has seen fit to allow on account of gifts by individuals or corporations are those specifically authorized in Sections 23(o) and 23(q); namely, contributions to charitable and similar organizations, and the amount deductible is limited to a percentage of the donor's income. Such contributions are exempt from the gift tax by Section 1004(a)(2).

clearly showing the right to the claimed deduction is on the taxpayer." *Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590, 593. See also *New Colonial Co.* v. *Helvering*, 292 U.S. 435, 440; *Deputy* v. *duPont*, 308 U.S. 488, 493; *Commissioner* v. *Jacobson*, 336 U.S. 28, 48-49; *McDonald* v. *Commissioner*, *supra*, p. 60. This rule acquires added significance in terms of the issue here presented, since the authorization in Section 23(a)(2) of deductions of certain non-business expenses must be read in conjunction and harmonized with the omnibus prohibition in Section 24(a) of deductions for personal expenses "in any case." Cf. *Commissioner* v. *Flowers*, 326 U.S. 465.

The District Court was of the opinion that to construe the statute as barring deduction of expenses incurred in contesting a gift tax deficiency "isn't justice under the law." (R. 30.) But whether an expense qualifies for deduction does not, as the District Court assumed (R. 30), turn on general equitable considerations. *Deputy* v. *duPont*, *supra*, p. 493; *Boehm* v. *Commissioner*, 326 U.S. 287, 295. Cf. *Rothensies* v. *Electric Battery Co.*, 329 U.S. 296.

Inherent in making a gift of property which, as in this case (R. 26-27), has no readily ascertainable market value, is the possibility that the Commissioner's valuation of the gift property may not coincide with the donor's. In such case the donor has the right, which he pursued with partial success in this case, of petitioning the Tax Court

for a redetermination of the deficiency (R. 27-28), and also of appealing from the Tax Court's decision. While the District Court stated that the taxpayer "contends" that the Commissioner's gift tax deficiency determination was "arbitrary and capricious" (R. 28), it made no finding to that effect, nor would the record support any such finding had it been made.[9] In any event, even assuming arguendo that the Commissioner's valuation was arbitrary, that would not serve to convert what is otherwise a non-deductible expense into a deductible one. In the words of this Court in *Deputy* v. *duPont, supra* (p. 493)—

> But allowance of deductions from gross income does not turn on general equitable considerations. It "depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed." *New Colonial Ice Co.* v. *Helvering*, 292 U.S. 435, 440.

---

[9] "All of the economic benefits of [property] must be taken into consideration in determining its value for gift tax purposes." *Guggenheim* v. *Rasquin*, 312 U.S. 254, 257. The Commissioner's gift tax deficiency notice, valuing the donated stock at $915.50 per share, stated that such valuation "is based upon consideration of the pertinent factors having a bearing upon the fair market value of such stock. Primary weight was given to the nature of the business and the net worth of the company." (Stipulation, Ex. 2 (R. 11) not made part of the printed record by reason of the granting of taxpayer's motion (Petition for certiorari, p. 10) to dispense with its printing.)

The stock was not listed on any exchange, and there had never been any sale of a substantial amount of it (R. 19, 26-27); moreover, the earnings of the corporation admittedly were dependent upon "many factors" and ran "more or less in cycles" (R. 20).

The taxpayer points to the financial hardship to which a donor is subjected when the Commissioner's valuation of gift property substantially exceeds his valuation and he is denied the right to deduct expenses of contesting the asserted gift tax deficiency in computing his income tax. Similar hardships confront a taxpayer of course in any case where a substantial personal claim is asserted against him and he is put to the expense (concededly non-deductible) of resisting it; for example, a suit to recover damages for accidental injury to private or governmental property. Any desired relief lies with Congress, however, not the courts. In answering like contentions of the taxpayer in *Boehm* v. *Commissioner*, *supra*, a case involving a claimed loss deduction under Section 23(e), this Court stated (p. 295):

> But these difficulties are inherent under the statute as now framed. Any desired remedy for such a situation, of course, lies with Congress rather than with the courts. It is beyond the judicial power to distort facts or to disregard legislative intent in order to provide equitable relief in a particular situation.

The taxpayer's contention that his motive for transferring the stock was not only love but also to maintain the family interest in the corporation, to achieve continuity of management, and to fortify the value of the stock retained by him does not justify the deduction (R. 19-21). The argument really combines (and confuses) three separate

ideas, none of which, separately or in combination, supports the taxpayer's claim.

(a) The first concept is really one of estate planning—the objective of retaining control of the corporation in the family as a unit. As we have pointed out above, footnote 3 *supra*, p. 14, this may be a sound enough policy, but it does not support a claim that the gift is a part of the management of the taxpayer's own property.

(b) The second concept is that it is sound business, from the point of view of the corporation, to interest the younger members of the family in its management, so as to assure continuity; but that does not aid the taxpayer in establishing that the gift served to produce income for him or to conserve or maintain his personal property. *Deputy* v. *duPont*, *supra*, at pp. 493-494; *cf. Interstate Transit Lines* v. *Commissioner*, *supra*.[10]

(c) The third concept is that the hoped-for participation in the management of the corporation by the donees would increase the taxpayer's earnings as a stockholder and thereby fortify the value of the shares retained by him. This theory really has no application to the gifts to the two unmar-

[10] In the *duPont* case, a stockholder attempted to deduct expenses incurred under a plan to increase the efficiency of the management of his corporation by selling stock to key executives. This Court stated, at page 494, "The fact that the transaction out of which the carrying charges here in question arose might benefit respondent does not bring it within the ambit of his alleged business of conserving and enhancing his estate. The well-established decisions of this Court do not permit any such blending of the corporation's business with the business of its stockholders."

ried daughters (one of whom was a minor) or to the wife; the taxpayer's own testimony attempted to support the argument only by reference to the gift to his son, who was a minor at the time but who has since reached his majority and become active in the corporation (R. 24-25, 21). Aside from the question of whether it would be an "ordinary" method of producing income, or of managing or conserving one's property, to give away a third of it, the main fault with the argument is that it proves too much. If a gift of stock were deemed an act designed to profit the donor, the amount of the gift itself would be a deductible expense under Section 23(a)(2). No such deduction is or can be claimed by the taxpayer, and the reasons which preclude it apply *a fortiori* to expenses incidential to the gift.

C. *The decision below is in accord with the decisions of this Court*

In dealing with business expense deductions claimed under Section 23(a)(1) this Court has repeatedly held that to qualify for deduction the expense must be directly connected with or proximately result from the carrying on of the business. *McDonald* v. *Commissioner, supra; Commissioner* v. *Flowers, supra; Commissioner* v. *Heininger, supra, Deputy* v. *duPont, supra; Interstate Transit Lines* v. *Commissioner, supra; Kornhauser* v. *United States*, 276 U. S. 145. The same test applies to deductions claimed under Section 23 (a) (2),

which is *in pari materia* with Section 23 (a) (1), except that the expense must be directly connected with or proximately result from carrying on activities of producing income, or managing or conserving income-producing property. *Bingham's Trust* v. *Commissioner, supra; McDonald* v. *Commissioner, supra.*

Gift tax litigation expenses—whether the gift is of business or non-business assets—cannot meet that test for the simple reason that such expenses are proximately related to the gift, a personal transaction having nothing to do with the conduct of a business or with the production of non-business income or the management of non-business property. It could not be seriously contended that a taxpayer engaged in business who made a gift of some or all of his business assets would be entitled under Section 23(a)(1) to deduct expenses of litigating gift tax liability as expenses proximately related to the conduct of his business. A taxpayer who makes a gift of some or all of his non-business assets can stand on no different footing, for a gift is no more proximately related to the carrying on of the non-business activities described in Section 23(a)(2) than to the carrying on of business activities.

Nothing in the opinion of this Court in *Bingham's Trust* v. *Commissioner, supra,* upon which taxpayer relies, detracts from its earlier observation (*McDonald* v. *Commissioner, supra,* p. 62)

that Section 23(a)(2) was enacted "for the restricted purpose which originated it," or suggests that expenses of litigating gift tax liability are embraced by that restricted purpose. In the *Bingham* case the testamentary trustees of a residuary estate paid fees for legal advice on problems related to final distribution of the trust fund, and for legal services in contesting an *income* tax deficiency based upon appreciation of the value of securities turned over to a legatee in lieu of cash. The Government challenged the deduction of these expenses on the ground that they were incurred after the trust term had expired, and hence at a time when the trust property was ready for distribution and no longer held for the production of income. After stressing that Section 23(a)(2) authorizes the deduction of expenses for the "management" of income producing property, as well as for the production of income, this Court stated (~~pp. 375-376~~):

> But the duties of the trustees were not only to hold the property for the production of income and to collect the income, but also, in administering the trust, to distribute the income and the principal so held from time to time, and the remainder of the principal at the expiration of the trust. Performance of each of these duties is an integral part of carrying out the trust enterprise. Accordingly, as the Tax Court held, the costs of distribution here were quite as much expenses of a function of "management" of the trust

property as were expenses incurred in producing the trust income; and if "ordinary and necessary," they were deductible.

* * * * * *

What we have said applies with equal force to the expenses of contesting the tax deficiency. Section 23(a)(2) does not restrict deductions to those litigation expenses which alone produce income. On the contrary, by its terms and in analogy with the rule under § 23(a)(1), the business expense section, the trust, a taxable entity like a business, may deduct litigation expenses when they are directly connected with or proximately result from the enterprise—the management of property held for production of income.

The Court also (pp. 375-377) relied upon provisions of the Treasury Regulations dealing with administration expenses of trustees, and stated that insofar as those provisions purported to allow deductions only of litigation expenses related to "production" of income, and to deny those related to "management" of the trust estate, they would not be in conformity with the statute.

The vital difference between this and the *Bingham* case is that the expenses of the Bingham trustees were not incurred in making gifts as was the expense here involved, but in managing trust property held by them for the benefit of the decedent's legatees. Unlike the administration expenses of the Bingham trustees, the gift expense

here involved bore no relation to the "management" of property held for the production of income. Nor was taxpayer under a fiduciary duty to distribute property committed to his trust, as were the Bingham trustees. To use the language of this Court in the *Bingham* case, the taxpayer's act of making a gift was not a part of the "duties of * * * trustees" nor "an integral part of carrying out [a] trust enterprise"; and his expenses connected with the gift were not "expenses of a function of 'management'." The very considerations which impelled this Court in the *Bingham* case to hold that the administration expenses of a trust are within the purview of Section 23(a)(2) would seem to require an opposite conclusion with respect to personal expenses incurred by a donor in making a gift. See *Commissioner* v. *Heide*, 165 F. 2d 699 (C.A. 2d); *Commissioner* v. *Josephs*, 168 F. 2d 233 (C.A. 8th); *Bagley* v. *Commissioner*, 8 T.C. 130.

In the only case (other than the instant one) involving the deductibility of expenses incurred in contesting a gift tax deficiency, both the Tax Court and the Court of Appeals have held that such expenses do not qualify for deduction under Section 23(a)(2). *Cobb* v. *Commissioner*, 10 T.C. 380, affirmed, 173 F. 2d 711 (C.A. 6th), certiorari denied, 338 U.S. 832, rehearing denied, 338 U.S. 882. The opinion of the Court of Appeals in that case fully distinguishes the *Bingham* case, and substantially the same arguments as taxpayer here advances were there rejected. The Court of Appeals in the

Cobb case refused (p. 715) to "adopt the impractical concept that giving away property produces income to the donor, or constitutes either management or conservation of the property." We believe that the reasoning of the court in that case, concurred in by the court below (R. 36), is sound and effectively disposes of taxpayer's contentions here.

II

The Treasury Regulation Barring the Claimed Deduction Is Valid

Congress has authorized the Commissioner, with the approval of the Secretary of the Treasury, to issue and publish interpretive regulations under the Internal Revenue Code. (Sections 62 and 3791 of the Internal Revenue Code).[11] The opening portion of Section 29.23(a)-15 of Treasury Regulations 111, which deals with the deductibility of expenses under Section 23(a)(2), provides that—

> * * * Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a)(2) only upon the condition that:

[11] The taxpayer attacks the regulation as not being the type which Congress authorized, on the ground that it purports to apply the general law to a specific situation (Br. 20). The tax regulations have for years abounded with this type of interpretation, and never has Congress or the courts questioned the propriety of such regulations. In fact, they are necessary to inform taxpayers how the Commissioner will apply the law to specific common situations. The validity of such regulations stands or falls on whether they are within the scope of the statutory provision they purport to apply.

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income, and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

Following the decision of this Court in the *Bingham* case, Section 29.23(a)-15(b) of the Regulations was amended by T.D. 5513, 1946-1 Cum. Bull. 61, to provide that—

Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under this section, notwithstanding that the estate or trust is not engaged in a trade or business, * * *
Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability as-

> serted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. *Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability* or even though, in the event of a claim for refund, the amount received will be held by him for the production of income. [Italics supplied.]

This Court has (*Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501) "many times declared that Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons." See also *Fawcus Machine Co.* v. *United States*, 282 U.S. 375, 378; *Brewster* v. *Gage*, 280 U.S. 327; *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90; *Helvering* v. *Reynolds Co.*, 306 U.S. 110. This admonition applies to amendments or clarifications made "to meet administrative exigencies or to conform to judicial decision." *Morrissey* v. *Commissioner*, 296 U.S. 344, 355.

The District Court held (R. 30-31) that insofar as the regulation precludes the deduction of expenses incurred in determining gift tax liability it is in conflict with the statute and unauthorized. Far from being in conflict with the statute, the regulation represents, as the court below held (R. 37), "a reasonable and consistent interpretation" of the Congressional intent disclosed by the language of the statute and its background. The most that may be said in taxpayer's favor is that the provisions of Section 23(a)(2) are susceptible of more than one reasonable interpretation insofar as gift tax litigation expenses are concerned. Even assuming that the interpretation which taxpayer urges and the District Court adopted is reasonable, however, certainly the Treasury's interpretation is not any the less reasonable. *Morrissey* v. *Commissioner, supra,* pp. 354,356. The Regulation constitutes a construction of the statute by the department charged with the duty and responsibility of its administration. It cannot be said to be so "plainly inconsistent" (*Commissioner* v. *South Texas Co. supra,* p. 501) with the statute as to be arbitrary and unauthorized, especially in the light of the rule, often reiterated by this Court, that deduction provisions are matters of legislative grace and must be strictly construed.

Furthermore, since the above provisions of the regulation were promulgated, Congress has several times extensively amended the Internal Revenue

Code[12] without changing the statutory provision to which they are addressed. Under familiar rules governing the construction of taxing statutes, the Treasury's interpretation must be deemed to have received implied legislative approval by virtue of substantial reenactment of the statute. *Helvering* v. *Winmill,* 305 U. S. 79, 83; *Commissioner* v. *Flowers,* 326 U. S. 465, 469; *Boehm* v. *Commissioner,* 326 U. S. 287.

The provisions of the regulation denying the deduction of expenses incurred in litigating *gift* tax liability are not, as taxpayer charges, inconsistent with those permitting the deduction of expenses incurred in litigating *income* tax liability.[13] The income tax is imposed upon net "income" earned in a taxable year (Code Section 11), while the gift tax is imposed "upon the transfer * * * of property" (Section 1000(a)); and expenses incurred in litigating the two types of taxes may not be assimilated for purposes of applying the business and non-business expense deduction provisions of the income taxing statute. Expenses of contesting income tax liability imposed on business or non-business income are directly related to

[12] E.g., Revenue Act of 1948, c. 168, 62 Stat. 110; Revenue Act of 1950, Public Law 814, 81st Cong., 2d Sess.; Revenue Act of 1951, Public Law 183, 82nd Cong., 1st Sess.

[13] In the *Bingham* case, the expenses incurred by the trustees in contesting the income tax deficiency asserted against the trust were held deductible on the ground (p. 376) that these expenses, like the other administration expenses of the trust, were directly connected with the "management" of the trust property.

the production of the income or to the management of property which produces the income.[14] Expenses of contesting gift tax liability lack this essential relationship, since they are directly related to a *transfer* of property from one taxpayer to another, a personal transaction unrelated to the production of business or non-business income or to the management of the property which produces it. *Cobb* v. *Commissioner, supra.* See 63 Harv. L. Rev. 357 (1949). Expenses incurred in resisting gift tax liability are no more proximately related to the production of income or the management of income-producing property than expenses incurred in defending any personal law suit.

III.

The Court Below Did Not Exceed Its Reviewing Powers in Reversing the District Court

There is no merit in taxpayer's contention that this case presents a question of "fact", with respect to which the District Court's decision is entitled to

---

[14] As was pointed out in *Kornhauser* v. *United States*, 276 U.S. 145, 153, in connection with business expenses, there is no real difference between an expenditure for attorney's fees made to secure payment of business income and a like expenditure to retain such income after its receipt. One is as directly connected with the business (under Section 23(a)(2) with the enterprise of producing and collecting income) as the other. See also *Commissioner* v. *Heininger, supra.* Litigation expenses incurred in contesting *gift* tax liability are not directly related to the production or retention of income; on the other hand, expenses incurred by the donor in seeking to deduct such expenses in computing his *income* tax are so related.

finality. The crucial and undisputed fact dispositive of this case is that the expense in question was incurred in litigating gift tax liability. Whether an expense of this nature is deductible under Section 23(a)(2) presents a reviewable question of law turning on the meaning of the words of that section. In the *Bingham* case, upon which taxpayer relies, this Court stated (p. 371):

> The questions whether, on the facts found, the expenses in question are nondeductible, either because they were not to produce income or because they were related to the management of property which was not held for the production of income, turn in this case on the meaning of the words of § 23 (a) (2), "property held for the production of income." They are therefore questions of law, decision of which is unembarrassed by any disputed question of fact or any necessity to draw an inference of fact from the basic findings. * * * They are "clear cut" questions of law, decision of which by the Tax Court does not foreclose their decision by appellate courts * * *.

Furthermore, the District Court made no attempt to determine whether the expense in question was directly connected with or proximately resulted from activity described in Section 23(a)(2). It reached its decision not by making a factual determination as to whether the expense falls

within the class allowed by the statute, but because of the mistaken conviction that its allowance was required as a matter of law. It assumed that such result was demanded by the decision of this Court in the *Bingham* case and, moreover, that the applicable Treasury Regulation, as amended after the *Bingham* decision, was in conflict with the statute and that decision (R. 30-31). It thereby adopted a general rule applicable to all gift tax litigation expenses, and its decision is therefore one of law clearly subject to a broader appellate review than that appropriate with respect to factual issues. *Commissioner* v. *Heininger, supra*, pp. 470-471, 475; *McDonald* v. *Commissioner, supra*, p. 64; cf. *Commissioner* v. *Estate of Bedford*, 325 U. S. 283; *Dobson* v. *Commissioner*, 320 U. S. 489, 502.

In any event, assuming that this case presents only a question of fact, reversal of the District Court's decision by the court below was nevertheless correct for the reason that the decision of the District Court is "clearly erroneous" in the light of the undisputed fact that the expense was incurred in contesting gift tax liability, and the inescapable conclusion that the expense was directly connected with a gift of property. Rule 52(a), Federal Rules of Civil Procedure; *United States* v. *Gypsum Co.*, 333 U. S. 364, 395; *United States* v. *Yellow Cab Co.*, 338 U. S. 338, 340-342.

Equally untenable is taxpayer's suggestion that

this case must be remanded to the District Court for additional findings of fact. There is no further evidence or finding which could conceivably erase the critical fact that the expense was incurred in litigating gift tax liability. Remand of the case would therefore be futile. *General Utilities Co.* v. *Helvering*, 296 U. S. 200, 206-207; *Estate of Spiegel* v. *Commissioner*, 335 U. S. 701, 707; *Hormel* v. *Helvering*, 312 U. S. 552, 559-560.

CONCLUSION

The judgment of the Court of Appeals is correct and should be affirmed.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

ELLIS N. SLACK,
Acting Assistant Attorney General.

JOHN F. DAVIS,
HARRY BAUM,
Special Assistants to the Attorney General.

NOVEMBER, 1951.

APPENDIX A

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121 (a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he had no equity.

* * * * * *

(2) *Non-trade or non-business Expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

* * * * *

(26 U.S.C. 1946 ed., Sec. 24.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.23(a)-15. *Nontrade or Nonbusiness Expenses.*

(a) *In general.*—Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23 (a) (2) only upon the condition that:

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely in-

come of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter incurred in connection therewith are deductible. Similarly, ordinary and necessary expenses incurred in the management, conservation or maintenance of a building devoted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of prop-

erty held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) [as amended by T.D. 5513, 1946-1 Cum. Bull. 61, 62] Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. Section 24 (a) (5) disallows any amount otherwise allowable as a deduction (whether under section 23 (a) (2) or otherwise) which is allocable to one or more classes of tax-exempt income, other than interest, and has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts otherwise allowable under that section which are allocable to tax-exempt interest. Thus, any amount allocable to the production or collection of one or more classes of income which is not includible in gross income or to the management, conservation, or main-

tenance of property held for the production of such income is not deductible under section 23 (a) (2). Nor does section 23 (a) (2) allow any expenses which are disallowed by any of the provisions of chapter 1.

* * * * * *

Fees for services of investment counsel, custodian fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under section 23(a)(2) only if (1) they are paid or incurred by the taxpayer for the production or collection of income, or for the management, conservation, or maintenance of investments held by him for the production of income; and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer to such investment.

* * * * * *

Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under this section, notwithstanding that the estate or trust is not engaged in a trade or business, except to the extent that such expenses are allocable to the production or collection of tax-exempt income. But see section 29.162-1 for disallowance of such deductions to an estate where such items are

claimed as a deduction under section 812 (b) in computing the net estate subject to the estate tax.

Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring to the ward or minor, or in connection with the management, conservation, or maintenance of property, held for the production of income, belonging to the ward or minor, are deductible.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible, but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible expenses. Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property

tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income.

* * * * *

APPENDIX B

H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74-75 (1942-2 Cum. Bull. 372, 410, 429-430):

The existing law allows taxpayers to deduct expenses incurred in connection with a trade or business. Due partly to the inadequacy of the statute and partly to court decisions, nontrade or nonbusiness expenses are not deductible, although nontrade or nonbusiness income is fully subject to tax. The bill corrects this inequity by allowing all of the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, conservation, or maintenance of

property held for the production of income. Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable.

* * * * *

This amendment allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section it must have been incurred either (1) for the production or collection of income or (2) for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a)(2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose

comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction, under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. Section

24 (a)(5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a)(2) or otherwise, which is allocable to one or more cases of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a)(2) for amounts allowable under that section which are allocable to tax-exempt interest.

* * * * * *

S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87-88 (1942-2 Cum. Bull. 504, 570-571), is substantially the same.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1951 64300 455

LIBRARY
SUPREME COURT, U.S.

Office-Supreme Court, U. S.
FILED
NOV 3 1951
CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

October Term 1951

No. 173

JOSEPH T. LYKES,
Petitioner,

VERSUS

UNITED STATES OF AMERICA,
Respondent

On Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE PETITIONER JOSEPH T. LYKES

CHESTER H. FERGUSON,
GEORGE W. ERICKSEN,
Attorneys for Petitioner

MACFARLANE, FERGUSON,
ALLISON & KELLY,
P. O. Box 1531
Tampa, Florida
Of Counsel:

THE FREE PRESS—TAMPA, FLORIDA

INDEX

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	2
Statute and regulations involved	2
Questions presented	3
Statement of the case	4
Procedure in the courts below	4
Statement of facts	5
Specification of errors	8
Outline of argument	9
Argument	13
Statement of points of law	13
The construction of Section 23 (a) (2) of the Internal Revenue Code	14
Validity of Regulations 111, Section 29.23 (a) -15 (b)	18
The effect of a determination on the facts by the District Court	25
Conclusion	35
Appendix A	
Treasury Regulations 111, Section 29.23 (a) -15	37

LIST OF AUTHORITIES
Table of Cases

Page

Aetna Insurance Co. vs. Boon,
95 US 117, 130; 24 L ed 395 22

Appeal of Sarah Backer et al, 1 BTA 214 ..... 11, 21

Nancy Reynolds Bagley, 8 TC 130 ..... 13, 30

Bingham's Trust vs. Commisioner of Internal Revenue, 325 US 365; 89 L ed 1670
8, 9, 11, 12, 18, 21, 22, 23, 24, 28, 29, 30, 35

Mary Lily Bingham, 2 TC 853; (1943) 23, 29

Busey vs. Deshler Hotel Co.,
130 F 2d 187, 190; 142 ALR 563 ..... 10, 20

Marion A. Burt Beck, 15 TC 642, 669 ..... 14, 18

Cobb vs. Commissioner, 173 F 2d 711, (CA, 6, 1949)
13, 18, 23, 24, 31, 33, 34

Commissioner vs. Heininger,
320 US at 471, 88 L ed at 175 ..... 11, 21, 22

Commissioner vs. Jacobson,
336 US 28; 93 L ed 477 ..... 9, 15, 17

Dobson vs. Commissioner,
320 US 489, 88 L ed 248, 64, S Ct. 239 28

Helvering vs. Bliss, 293 US 144; 79 L ed 247 ..... 10, 16

Higgins vs. Commissioner of Internal Revenue,
312 US 212; 85 L ed 783 ..... 9, 10, 14, 16, 17, 18, 22

Kornhauser vs. United States,
276 US at 153, 72 L ed at 507 ..... 11, 21

Lowden vs. Hanson, 134 F 2d 348 (CCA, 8, 1943) 26

Massachusetts Bonding vs. Preferred Automobile Insurance Co., 110 F 2d, 764 (CCA, 8, 1940) 12, 25

Mayo vs. Lakeland Highlands Canning Co.,
309 US 310; 84 L ed 774 ..... 12, 26

McDonald vs. Commissioner,
323 US 57; 87 L ed 75 ..... 9, 10, 12, 14, 15, 17, 18, 28

Page

Miles vs. Van Hagen, 128 F 2d 89, District Court of Appeals, 2nd District, California, 1942 22

Miller vs. United States, 294 US 435; 79 L ed 977 ..... 10, 20

New Colonial Company vs. Helvering, 292 US 435; 78 L ed 1348 ..... 9, 15

O'Neill vs. City of Port Jervis, 253 N.Y. 423, 171 NE 694 22

Public Service Commission vs. Wisconsin Telephone Co., 289 US 68; 77 L ed 1036 26

Stoddard vs. Commissioner, 152 F 2d 445 (2d Circ. 1945); 2 Tax L. Rev. 39 (1946) 23

Stout vs. Commissioner of Internal Revenue, 185 F 2d 854 (CA, 6, 1950) 26

United States vs. Yellow Cab Co., 338 US 338; 94 L ed 150 ..... 11, 26

Waite vs. Macy, 246 US 606; 62 L ed 892 ..... 10, 20

Webster-Brinkley Co. vs. Belfield, 166 F 2d 814 (CCA, 9, 1948) 26

Texts, Etc.

56 Harvard Law Review 1142 15

63 Harvard Law Review 358, December 1949 ..... 11, 24

Nahstoll, Non-trade and Non-business Deductions, 46 Mich. L. Rev. at 1015 et seq. 9, 10, 14, 15, 18, 33

1 Shearman and Redfield on Negligence, Revised Edition, pages 94, 99; Sections 35, 37 22, 33

Trachtman's Estate Planning, 1949 Edition, Practicing Law Institute, pages 136-151 30

Statutes, Rules and Regulations

	Page
Federal Rules of Civil Procedure, Rule 52	11, 25, 26
Internal Revenue Code:	
Section 23 (a) (1)	2, 16, 20
Section 23 (a) (2)	2, 3, 12, 13, 14, 17, 18, 20, 21, 30, 35
Section 24 (a) (1)	24, 33
Sections 161, 162	12
Section 1009	11, 24
Section 1141 (a)	28
Judicial Code: Section 1254 (1) (28 USC Section 1254 (1))	2
Section 24 (20) (28 USCA 41 (20))	4
Revenue Act 1951,	16, 17
Report of the Committee on Finance, United States Senate, Report No. 781, 82nd Congress, 1st Session	16, 17
Treasury Department Regulations 111, Section 29.23 (a) -15 (in full in Appendix A, pp. 37 et seq.)	10, 14, 18, 21, 23, 33
Treasury Decision 5513, 1946 Internal Revenue Bulletin, page 61	18

IN THE

Supreme Court of the United States

OCTOBER TERM, 1951

No. 173

JOSEPH T. LYKES,
Petitioner,

VERSUS

UNITED STATES OF AMERICA,
Respondent

On Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE PETITIONER JOSEPH T. LYKES

OPINIONS BELOW

The opinion of the Court of Appeals (R. 58-63) is reported at 188 F. 2d 964. The memorandum opinion of the District Court (R. 44-49) is reported at 84 F. Supp. 537.

JURISDICTION

The judgment of the Court of Appeals was entered April 27, 1951 (R. 58, 63).

In an order dated October 8, 1951, this Court granted the petition for certiorari filed July 5, 1951.

The jurisdiction of this Court is invoked under Section 1254 (1) of the Judicial Code, being 28 U S C Section 1254 (1).

STATUTE AND REGULATIONS INVOLVED

The statute involved is Section 23 of the Internal Revenue Code (26 U S C Section 23) as amended by Section 127 (a) of the Revenue Act of 1942, c 619, 56 Stat 798. The applicable portion of that statute reads as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments re-

quired to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he had no equity.

* * *

(2) *Non-trade or non-business Expenses.*

—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

The Regulations of the Treasury Department here involved (Regulations 111, Section 29.23 (a) (15) have been set out as Appendix A of this Brief.

QUESTIONS PRESENTED

The petitioner contends that the Court of Appeals erred in its apparent determination that any litigation related to gift taxes necessarily means that the expenses of that litigation are not deductible under Section 23 (a) (2) of the Internal Revenue Code. The question, therefore, is:

Was the District Court correct in determining that under some circumstances litigation expenses involving gift taxes *are* deductible from income as non-trade or non-business expenses incurred in the "management, conservation, or maintenance of property held for the production of income;" and that such expenses were properly deductible under the facts and circumstances of the instant case?

The Petitioner contends that the District Court's determination was proper, and that the question should be answered in the affirmative.

STATEMENT OF THE CASE

Procedure in the Courts Below. This case was started in the United States Court for the Southern District of Florida by the filing of a complaint against the United States under Section 24 (20) of the Judicial Code as Amended (28 U S CA 41 (20)) for the refund of federal income taxes overpaid for the calendar year 1944 in the amount of $5,665.78, plus interest (R 2). After an answer which principally denied the facts (R 15-16), the case went to final hearing (R 17 et seq.). The only witnesses were the plaintiff and an accountant who testified in his behalf concerning the tax calculation.

On June 8, 1949, the District Judge filed his Memorandum Decision (R 44 et seq.) ordering judgment for the plaintiff (R 49), and Judgment pursuant thereto, dated November 14, 1949 (R 50), was filed November 15, 1949.

On Notice of Appeal filed January 14, 1950, and amended Notice of Appeal filed February 23, 1950, (R 51), the case went to the United States Court of Appeals for the Fifth Circuit, which on April 27, 1951, filed its opinion (R 58-63) and judgment (R 63) reversing the District Court.

The case is in this Court on order granting petition for certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit, dated October 8, 1951.

Statement of Facts. The facts as affirmatively found in the Memorandum Decision of the District Court are as follows (R 44-46):

The taxpayer is and has been for many years a stockholder in Lykes Brothers, Inc., a family corporation. The stock of the corporation has been closely held throughout its existence and there is not nor has there ever been an open market price for the stock. In the year 1940 taxpayer made gifts of 1,000 shares of stock of the corporation, owned by him, to members of his family, as follows (R. 44):

250 shares to Margaret K. Lykes, his wife
250 shares to Margaret H. Lykes, his daughter
250 shares to Elizabeth L. Lykes, his daughter
250 shares to Joseph T. Lykes, Jr., his son

It appears from the testimony that one of the daughters had reached her majority at the time of the gifts, but the other two children were minors. All of the children made their home with the taxpayer, were unmarried and neither the wife nor the children took any part in the management of the business of Lykes Brothers, Inc., at the time of the gifts. (R. 44.)

The motive for the gifts, as stated in the taxpayer's gift tax return, was love. The taxpayer testified to additional motives, the principal one of which was the accepted custom or policy of himself and his brothers to make such gifts to their children to insure continuity of the ownership and management of the company. The evidence shows this custom has been pursued by other members of the Lykes family. (R. 45.)

At the time the gift tax return was filed, taxpayer valued the stock at $120 per share and paid a gift tax thereon in the sum of $13,032.75. The taxpayer testi-

fied he took as a guide in determining the value of the stock the only arm's-length transaction of importance during that year of which he had knowledge—the sale of several hundred shares by an executive (not a member of the Lykes family) to other executives of the company. He testified he also took into consideration the hazards then confronting the business and reached the conclusion that the market value established by the sale represented the fair value of the stock at the time. (R. 45.)

On March 3, 1944, the Commissioner of Internal Revenue formally notified the taxpayer that a determination of his gift tax liability for 1940 disclosed a deficiency of $145,276.50 and a deficiency in that amount was assessed against taxpayer. He also was notified of his right to petition the Tax Court for a redetermination of such deficiency liability. (R. 45.)

The taxpayer engaged K. I. McKay, an attorney at law, to represent him in this matter and a petition for redetermination of the liability was filed with the Tax Court. After taxpayer's attorney had prepared and filed such petition and prepared his case for trial, a compromise settlement was reached and the Tax Court, pursuant to stipulation of the parties, found a deficiency in taxpayer's gift tax return in the sum of $15,612.75, which was promptly paid. The taxpayer paid his attorney $7,263.83 in the year 1944 for services in this matter. (R. 45-46.)

Furthermore, the District Court found that if the payment of attorney's fees was a deductible expense from gross income for the year of payment, then the plaintiff-taxpayer (petitioner herein) was entitled to recover $5,665.78 with interest (R. 46) and ultimately gave judgment in that amount. (R. 50.)

We contend that the District Court, in finding for the plaintiff-taxpayer, necessarily found as facts the factual matters set out in the opinion as the contentions of the plaintiff-taxpayer (R. 46), namely:

The payment of attorney's fees of $7,263.83 was made, not as the result of an ordinary contest concerning the valuation of ordinary personal gifts, but that it was a payment of legal expenses incurred to forestall the collection by the Government of an assessment of a tax which was so clearly arbitrary and capricious that in fact, it had nothing to do with the gift on which it was based.

Had that tax been successfully enforced against him it would have substantially destroyed his holdings in Lykes Brothers, Inc., and would have confiscated most of the property held by him for the production of income.

Furthermore, the record in this case is not long, and the evidence is uncontroverted. It is likely that the District Judge had this in mind in telescoping the factual matter developed at the trial into the compass of his short Memorandum Decision. Therefore, we consider that this Court should rely for its facts on all credible testimony developed at the trial (R. 25-26, 32-42), the general finding for the plaintiff, and the stipulated facts (R 19-21). On that basis we add the following pertinent facts as being, at a minimum, part of the statement of the case:

The petitioner (the taxpayer) did not give all of his shares away—only about one-third (R 36). Consequently, his ultimate purpose in following a plan of giving (R 33-34), was to "further fortify our *remaining* interest in company" (R 32) by bolstering the executive

staff (R 34-35). This policy of giving in order to fortify the balance of the interest in Lykes Brothers, Inc., which was retained, proved sound (R 34).

A substantial interest in Lykes Brothers, Inc., had been retained by the petitioner (taxpayer) through the time of the trial (R 37).

The payment of counsel fees which the petitioner (taxpayer) considered a proper deduction, occurred at the time of the assertion of the deficiency, and was for the immediate relief of that situation (R 37-38), and not for the successful conclusion of the Tax Court case, which occurred two years later (R 20-21).

SPECIFICATION OF ERRORS

The petitioner claims that the Court of Appeals erred in reversing the decision of the District Court; and, more specifically—

1. In refusing to give effect to the principles to be applied in the application of Section 23 (a) (2) of the Internal Revenue Code, as pronounced in *Bingham's Trust vs. Commissioner of Internal Revenue*, 325 US 365, 89 L ed 1670, and other cases in this Court therein cited.

2. In refusing to uphold the decision of the District Court which denied the applicability or validity of the Treasury Department's Regulations intended to interpret Section 23 (a) (2) of the Internal Revenue Code (being Regulations 111, Section 29.23 (a) -15, and thus conflicting with the *Bingham* case and other cases decided by this Court.

3. In refusing to uphold the decision of the District Court on the facts, and thus improperly ignoring the holding of this Court in *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 US 365, 89 L ed 1670, to the effect that the trial court's determination of whether a particular expense met the conditions of the statutory deduction was principally a question of fact (325 US at 371, 373, 376).

OUTLINE OF ARGUMENT

The argument follows the points stated in the Specification of Errors.

I. Section 23 (a) (2) of the Internal Revenue Code should be construed liberally in the taxpayer's favor.

A. Congressional enactment of that section was corrective of *Higgins vs. Commissioner,* 312 US 212; 85 L ed 783.

McDonald vs. Commissioner, 323 US at 67, 87 L ed at 75; Nahstoll, *Non-trade and Non-business Deductions,* 46 Mich L Rev, 1015, 1016, 1019.

B. The usual rule that exemptions statutes must be strictly construed *(New Colonial Company vs. Helvering,* 292 US 435, 440; 78 L ed 1348, 1352; *Commissioner vs. Jacobson,* 336 US 28, 49; 93 L ed 477, 489) must be tempered by;

1. Congressional intention to tax net income, not gross income.

McDonald vs. Commissioner, 323 US 57, 89 L ed 68, dissenting opinion by Mr. Justice Black at 323 US 67

Nahstoll, *Non-trade and Non-business Deductions*, 46 Mich L Rev at 1023

2. Corrective and liberalizing provisions in income tax laws shqulb be liberally construed in favor of the taxpayer.

Helvering vs. Bliss, 293 US 144, 150-151; 79 L ed 247.

C. Section 23 (a) (2) went beyond the immediate problem of the *Higgins* case, and should not be limited in its application to the injustice which Congress perceived was present in that case.

McDonald vs. Commissioner, 323 US 57, 89 L ed 68, dissenting opinion of Mr. Justice Black at 323 US 67.

II. Regulations 111, Section 29.23 (a) -15 (b), as interpreted by the Court of Appeals, is invalid.

A. The Court of Appeals did not properly construe the Regulations, by assuming that a mere example was interpretive of the statute, and had the force and effect of law.

B. A factual example is invalid as an interpretation of the statute.

Miller vs. United States, 294 US 435, 439-440; 79 L ed 977, 980-981.

Waite vs. Macy, 246 US 606, 609; 62 L ed 892.

Busey vs. Deshler Hotel Co., 130 F 2d 187, 190; 142 ALR 563.

C. The Regulations are invalid as in conflict with decisions of this Court which determine that the matters considered by the Regulations are factual and not matters of law.

Bingham's Trust vs. Commissioner, 325 US at 374, 89 L ed at 1677.

Kornhauser vs. United States, 276 US at 153, 72 L ed at 507.

Appeal of Sarah Backer et al, 1 BTA 214, 216.

Commissioner vs. Heininger, 320 US at 471, 88 L ed at 175.

D. The Regulations are invalid as inconsistent within themselves.

63 *Harvard Law Review* 358, December, 1949.

E. The Regulations are unreasonable in making deductions depend on the whim of the Commissioner—that is, whether he choses to assert tax deficiencies against the donor or the donees. Section 1009, *Internal Revenue Code*.

III. The Determination by the District Court was essentially on a question of fact, and it should not be reversed unless clearly erroneous.

Bingham's Trust vs. Commissioner, 325 US 365, 370, 373, 376; 89 L ed 1670.

Federal Rules of Civil Procedure, Rule 52.

United States vs. Yellow Cab Co., 338 US 338; 94 L ed 150.

A. If the Court of Appeals founds the Memorandum Decision an inadequate source for the facts, it should have dismissed or remanded.

Massachusetts Bonding vs. Preferred Automobile Insurance Co., 110 F 2d, 764 (CCA, 8, 1940).

Mayo vs. Lakeland Highlands Canning Co., 309 US 310, 319; 84 L ed 774, 780.

B. A basic distinction between the *Bingham* case and the *McDonald* case is that in the former the trial court held for the taxpayer, and in the latter *against him.*

McDonald vs. Commissioner, 323 US 57, 64; 89 L ed 68, 74.

Bingham's Trust vs. Commissioner, 325 US 365, 370; 89 L ed 1670, 1675.

C. Any questions of law in the instant case were decided in favor of the taxpayer in the *Bingham* case.

Bingham's Trust vs. Commissioner, 325 US at 371, 372, 375; 89 L ed 1670, 1675, 1676, 1677, 1678.

1. Section 23 (a) (2) is applicable to a trust only by virtue of Sections 161 and 162 of the Internal Revenue Code.

Bingham's Trust vs. Commissioner, 325 US 365, 368; 89 L ed 1670, 1674.

2. There is no distinction between the application of Section 23 (a) (2) to a trust and to the individual's income producing "estate".

Nancy Reynolds Bagley, 8 TC 130.

3. The case of *Cobb vs. Commissioner*, 173 F. 2d 711, was erroneously decided; but in any event this case and the *Cobb* case are distinguishable, not only on the basis of the different results obtained in the trial court, but on the facts.

a. The gift was not a purely personal transaction.

b. Assuming, contrary to fact, that the gift was purely personal, it was not the gift which necessitated the legal expense, but an attack against the taxpayer by the Government of such magnitude that its arbitrary and capricious nature neutralized the personal aspect of the gift as a generating cause of the legal expenses.

ARGUMENT

Statement of Points of Law

This case involves three general subjects of inquiry. We consider that these are the matters of law which are involved:

1. The construction of Section 23 (a) (2) of the Internal Revenue Code;

2. The determination of the validity of the regulations which purport to interpret that statute,

i.e. Treasury Department Regulations 111, Section 29.23 (a) -15;

3. The effect of a determination on the facts by the trial court, in this case the United States District Court for the Southern District of Florida.

There are ancillary considerations which must be examined with regard to each one of these points, e.g. the determination of the clarity with which the factual findings appear in the Memorandum Decision of the District Judge; and the proper proceeding for the Court of Appeals in the event that such factual findings do not appear with sufficient clarity. We consider that, as a preliminary step, an examination of the basic law applicable to the case will be of aid to this Court in its review.

The Construction of Section 23 (a) (2) of the Internal Revenue Code

This section of the Code was added by amendment in 1942, following the decision of this Court in *Higgins vs. Commissioner of Internal Revenue,* 312 US 212; 85 L ed 783. It is generally considered that the Higgins case was responsible for that amendment. *McDonald vs. Commissioner of Internal Revenue,* 323 US at 67; 87 L ed at 75 (dissenting opinion of Mr. Justice Black); Nahstoll, *Non-trade and Non-business Expense Deductions; Section 23 (a) (2) of the Internal Revenue Code,* 46 Mich. L. Rev. 1015, 1016, 1019 (June, 1948); *Marion A. Burt Beck,* 15 TC 642, 669.

This section of the Code provides for a deduction from gross income. The Court of Appeals in this case referred to this section as dealing with exemptions, and thus determined that under the doctrine of *New*

Colonial Company vs. Helvering, 292 US 435, 440, 78 L ed 1348, 1352, the statute should be strictly construed (R. 61). We do not consider that that standard is applicable.

In general, the Federal statutes taxing income are so devised that, on the surface at least, there appears a congressional intention to tax gross income, i.e., all income which may properly be taxed under the 16th amendment; and under such circumstances it is general law that statutes permitting exemptions or deductions should be strictly construed. (*Commissioner of Internal Revenue vs. Jacobson*, 336 US 28, 49; 93 L ed 477, 489). But the basic pattern which has been established for federal taxation of income (including numerous Congressional enactments of the type being considered here) has led thoughtful legal scholars and judges to a different conclusion. Mr. Justice Black, in his dissenting opinion in the case of *McDonald vs. Commissioner of Internal Revenue*, 323 US 57, 67; 89 L ed 68, 75, stated:

> "Taxation on net, not on gross, income has always been the broad basic policy of income tax laws. Net income may be defined as what remains out of gross income after substracting the ordinary and necessary expenses incurred in efforts to obtain or to keep it."

Nahstoll, *Non-trade and Non-business Expense Deductions*, 46 Mich. L. Rev. 1015, 1023, adopts Professor Griswold's statement in his note in 56 Harv. L. Rev. 1142, 1144-1145, ". . . there is no need . . . to deny that Congress has very great power over the deductions which are allowed. *The fact remains that Congress has never sought to tax gross income.* We are not dealing with a question of power, but of intention. And the whole structure and history of the income tax makes it plain

that the intention of Congress to allow deductions has been just as clear as its intention to tax income."

Furthermore, construction of this statute should take into account the fact that it was intended by Congress to remedy a defect in the law arising out of the interpretation of Section 23 (a) (1) given by this Court in the *Higgins* case (312 US 212; 85 L ed 783). It is a corrective and liberalizing provision, and should be so construed.

> "If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed."

Helvering vs. Bliss, 293 US 144, 150-151; 79 L ed 247.

Present pressures for revenues necessarily lead to unduly restrictive administrative and judicial interpretations of statutes permitting exemptions and deuctions, if the theory of strict construction of exemption statutes is applied without due consideration to (1) the general intendment of Congress to tax only net income, and (2) the determination that Congressional liberalizations of law in the taxpayer's favor are to be liberally construed. This is not a situation which begins and ends with this case. Liberalizing corrections and recorrections are becoming a necessary Congressional habit.

The Revenue Act of 1951 is studded with examples. Referring to the presently available Senate version, the following sections are of this general character: Section 339, page 38, Senate Report; Section 324, pages 41-42,

Senate Report; Section 325, pages 42-43 Senate Report; Section 323, pages 43-48 Senate Report; Section 343, pages 48-49 Senate Report; Section 317, pages 57-58 Senate Report; and Section 342, pages 63-65 Senate Report. Many others are liberalizations in favor of the taxpayer without reference to administrative or judicial construction of existing law, e. g. Section 318, page 34 Senate Report; Section 319, page 37 Senate Report; Section 309, pages 43-48 Senate Report; Section 312, page 48 Senate Report; Section 334, pages 49-50 Senate Report; Section 302, page 50 Senate Report; Section 328, page 50 Senate Report; Section 330, pages 50-51 Senate Report; Section 307, page 51 Senate Report; Section 303, page 52 Senate Report; Section 321, pages 52-53 Senate Report; Section 340, pages 53-54 Senate Report; Section 331, pages 54-55 Senate Report; Section 304, pages 59-60 Senate Report; Section 315, page 61 Senate Report; and Section 337, page 62 Senate Report.

Numerically, the loop-hole closing sections seem to have lost out to those which liberalize the income tax laws—a definite indication of the intention of Congress to insist on the taxation of some net-income result. At the very least, the rule that "exemptions . . . should be construed with restraint" (*Commissioner of Internal Revenue vs. Jacobson*, 336 US 28, 49, 93 L ed 477, 489), should be applied with restraint where Congress has specifically liberalized the exemption or deduction.

In enacting Section 23 (a) (2), the Congress went beyond the immediate problem generated by the *Higgins* case (312 US 212; 85 L ed 283). As Mr. Justice Black stated in his dissenting opinion in the case of *McDonald vs. Commissioner of Internal Revenue*, 323 US 57, 67; 89 L ed 68, 76: "The language (Congress) utilized was certainly far broader than was required to

meet the narrow problem presented by the *Higgins* case." Whether that broadening appears in the first phrase concerning the expense of producing income (Mr. Justice Black's view in the *McDonald* case) or in the all-inclusive language concerning the management, conservation, or maintenance of property (see Nahstoll, *Non-trade and Non-business Expense Deductions,* 46 Mich L Rev at 1023, and note 31) is relatively unimportant. The broad language of Section 23 (a) (2) and the circumstances and history of its enactment condemn such interpretations as—"The *Higgins* case . . . is a clearly defined example of the nature of the deduction for which Congress intended to provide" by the enactment of Section 23 (a) (2) (*Marion A. Burt Beck,* 15 TC 642, 669; see also, as to the capital expenditure feature, the discussion in Nahstoll, *Non-trade and Non-business Expense Deductions,* 46 Mich L Rev at 1024-1027).

Bingham's Trust vs. Commissioner of Internal Revenue, 325 US 365; 89 L ed 1670, is the key case which permits a meaningful interpretation of all of Section 23 (a) (2); and we contend that the logic of that case, appropriately applied to the instant one, necessarily results in the conclusion that the Court of Appeals erred in reversing the District Court—and in relying on *Cobb vs. Commissioner,* 173 Fed 2d 711 (CA, 6, 1949) in so doing.

Validity of Regulations 111, Section 29.23 (a) -15 (b)

The *Bingham* case (325 US 365, 89 L ed 1670) resulted in the amendment of the Regulations interpreting Section 23 (a) (2) by T. D. 5513, 1946 *Internal Revenue Bulletin 61,* approved May 14, 1946. As so amended the

regulation is included as appendix A to this brief. It includes the following limitation on the application of Section 23 (a) (2) on which the Court of Appeals relied in reversing the District Court (R. 61, 62):

> *"Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability* or even though, in event of a claim for refund, the amount received will be held by him for the production of income."

As the Court of Appeals apparently construed this phrase, it is an absolute prohibition of the deduction of expenses incurred by an individual if they are in any manner related to a gift tax controversy (R 62). This cannot be correct. On its face it is merely an *example* of a possible disallowance under those preceding paragraphs which are actually interpretive. It is like a law school examination question, necesarily implying the absence of other facts and circumstances. It is an aid in the interpretation of the statute, but is not an interpretation of the statute (as might be, for example, most of the first two paragraphs of subsection (b) of the regulation). Consequently, when the District Judge found, as we contend, that there were other facts and circumstances (R. 45, 46) which took this case out of the classification of an ordinary gift tax controversy, that example in the regulations was inapplicable, and decision of this case then must be determined by the words of the statute and those paragraphs of the regulations which are interpretative.

But considering, as did the Court of Appeals, that the phrase quoted from the Regulations has "the force

and effect of law" (R. 61) and so "denies the deduction here claimed" (R. 62), can the regulation, as interpreted to deny deductions for all expenses related to gift tax controversies, be valid? We contend that it cannot.

The law as determined by this Court does not permit such a regulation to stand. While certain examples may be used as guides in interpreting legislation, they cannot be considered as absolute determinations of factual situations, foreclosing a true judicial determination of whether the facts in a particular case do or do not meet the statutory requirement.

> "Undoubtedly, the regulation in terms declares that permanent loss of the use of one hand and one eye shall be deemed to be total permanent disability under an insurance policy such as that issued to petitioner. But the regulation is both inapplicable and invalid.
>
> * * *
>
> "It is invalid because not within the authority conferred by the statute . . . It is not, in the sense of the statute, a regulation at all, but legislation. * * * The vice of the regulation, therefore, is that it assumes to convert what in the view of the statute is a question of fact requiring proof into a conclusive presumption which dispenses with proof and precludes dispute. This is beyond administrative power.". *Miller vs. United States,* 294 US 435, 439-440, 79 L ed 977, 980-981.

To the same effect, *Waite v. Macy,* 246 US 606, 609; 62 L ed 892; and also *Busey v. Deshler Hotel Co.,* 130 F 2d 187, 190; 142 ALR 563.

Furthermore, the standard test set up by the Courts for the application of both Section 23 (a) (1) and Section 23 (a) (2) is: Is the expense directly

connected with *or* does it *proximately result* from the conduct of the business, the production of income, or the management, maintenance, or conservation of property held for the production of income?

> *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 US at 374, 89 L ed at 1677.
>
> *Kornhauser vs. United States,* 276 US at 153, 72 L ed at 507.
>
> *Commissioner of Internal Revenue vs. Heininger,* 320 US at 471, 88 L ed at 175.

This test has been, substantially, adopted into the Regulations, which provide that "expenses, to be deductible under Section 23 (a) (2), must be 'ordinary and necessary,' which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income, or to the management, conservation, or maintenance of property held for the production of income." (Regulations 111, Section 29.23 (a) -15 (a), third paragraph).

This requirement of the proximity of the expense to the statutory objects of its use was first considered in one of the earliest cases in the Board of Tax Appeals, *Appeal of Sarah Backer,* et al, 1 BTA 214, 216. The Board there stated: "We are dealing here with the age-old question of *proximate cause.*" This phrase, long familiar to negligence practioners, has been variously defined.

> "'Legal or proximate cause is always dependent upon the facts of a particular case, and it is for this reason that the words are beyond definition or conclusive explanation'. This observation may account

in some degree for the widely varying concepts of proximate cause as revealed by examination of the cases."

1 *Shearman and Redfield on Negligence,* Revised Edition, page 94, Section 35; quoting Crane, J., in *O'Neill vs. City of Port Jervis,* 254 N.Y. 423, 433; 171 NE 694.

It is clear, however, that the disjunctive use of "direct" *or* "proximate" cause in the *Bingham* case (325 US at 374, 89 L ed at 1677) is appropriate. A result may be *indirect* but nevertheless proximate *(Aetna Insurance Co. vs. Boon,* 95 US 117, 130; 24 L ed 395, 399; *Miles vs. Van Hagen,* 128 P 2d 89, 92, District Court of Appeals, 2nd District, California, 1942). Consequently, the distinction of the Court of Appeals (R. 62) between a *proximate* and an *indirect* relationship is inappropriate.

Furthermore, the determination of proximity is essentially one of *fact,* to be settled by the trial court.

Bingham's Trust vs. Commissioner of Internal Revenue, 325 US at 370, 373, 376; 89 L ed at 1675, 1677, 1678.

Commissioner vs. Heininger, 320 US at 475, 88 L ed at 177.

Higgins vs. Commissioner of Internal Revenue, 312 US at 218; 85 L ed at 788.

But the Treasury Department's attempt, by the use of Regulations, to predetermine the factual results in cases such as the instant one, necessarily leads to the incongruous decisions referred to in the Harvard Law

Review note on *Cobb vs. Commissioner*, 173 F 2d 711 (CA, 6, 1949):

". . . although in one case the Tax Court relied on the lien theory in allowing the deduction by trustees of the cost of unsuccessful income tax litigation arising from payment of a bequest, see Mary Lily Bingham, 2 TC 853 (1943), the Supreme Court in affirming ignored the lien argument, reasoning that the expense was a 'proximate result' of the trustees' management duties in holding the trust property for the production of income. *Bingham's Trust v. Commissioner*, 325 US 365, 376 (1945), 58 Harv. L. Rev. 1254. Thus, it seems doubtful that the Court intended to sanction the argument, but subsequent courts ostensibly applying the 'proximate result' test summarily allowed income tax determination expenses on showings of proximity apparently no more substantial than that established by the taxpayer in the principal case. See, e.g., *Stoddard v. Commissioner*, 152 F. 2d 445 (2d Cir. 1945); 2 Tax L. Rev. 39, 59-64 (1946). Present treasury regulations accordingly permit the deduction of any expense of income tax determination, although they deny deductions for similar expenses connected with gift taxes; further, they expressly reject the lien theory. US Treas. Reg. 111, Paragraph 29.23 (a) -15 (1946). Ironically, although the Commissioner successfully denied the taxpayer in the principal case a deduction for his gift tax expenses, the cost of litigating that issue is deductible under the Regulations, since the controversy concerned income tax liability. Likewise, had the former determination not involved gift tax liability but validity of the gift for income tax purposes, i.e. whether income produced by the property which taxpayer transferred to his daughters was taxable to him, his expense would be deductible. In these cases, however, the contest is the result of a gift transaction and seems not to have resulted from the production of income, or the management or conservation of

property held for the production of income, to any greater extent than the determination in the *Cobb* case.

63 *Harvard Law Review* 358, December, 1949.

The Regulations, therefore, are not only invalid because they are legislative in character, but they are inconsistent within themselves, and hence not reasonable interpretations of the law.

In this regard we cite another example. Suppose that the Treasury Department had proceeded to collect the deficiency involved in the gift tax case from the *donees*, a procedure more likely to be followed if a donor gives away substantially all of his property. That alternative course could be taken by the Commissioner under Section 1009 of the Internal Revenue Code:

> "The tax imposed by this chapter shall be a lien upon all gifts made during the calendar year, for ten years from the time the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift . . ."

The legal expenses of the *donees* in protecting the income-producing properties from the lien of a deficiency assertion would appear to fall exactly within the terms of the statute. They are not personal expenses under Section 24 (a) (1) of the Code, and to say that they in any way enhance the value of the donated property, so as to be capital expenditures, seems patently absurd. It is equally absurd to say that Congress intended that legal expenses resulting from gift tax controversies should or should not be allowable deductions depending on the whim of the Commissioner—that is, whether he chooses to assert tax deficiencies against the donor or the donees.

We respectfully urge this Court to condemn the regulation, insofar as it may be construed to disallow all expenses of gift tax controversies, as unauthorized by the statute and as an unwarranted and unreasonable interpretation thereof.

The Effect of a Determination on the Facts by the District Court

We have already referred generally to this Court's determination that the question of proximity is essentially a fact question on which the Trial Court should not be reversed, unless its decision was clearly erroneous. *Bingham's Trust vs. Commissioner of Internal Revenue,* 325 US 365, 370, 373, 376; 89 L ed 1670.

As we have pointed out in the Memorandum Brief in support of the petition for certiorari, in the instant case, the District Court did not make specific findings of fact, but wrote a Memorandum Decision ordering judgment for the plaintiff (R 44-49). Such memorandum decisions are "sufficient if the findings of fact and conclusions of law appear therein" *Federal Rules of Civil Procedure, Rule 52.* The Court of Appeals did not consider the District Court's findings, and, in effect, made findings of its own. We cannot, therefore, determine whether the Court of Appeals found the District Court's findings adequate. If they were not, then the Court of Appeals either:

(1) cannot act, because of a failure to present a reviewable question for determination *(Massachusetts Bonding Co. v. Preferred Automobile Ins. Co.,* 110 F 2d 764-CCA, 8, 1940), or

(2) must remand, so that "any action taken by the Court shall be upon findings of fact and conclusions founded upon the evidence, in ac-

cordance with Rule 52 (a) of The Rules of Civil Procedure".

Mayo v. Lakeland Highlands Canning Co., 309 US 310, 319, 84 L ed 774, 780; also, *Webster-Brinkley Co. v. Belfield*, 166 F 2d 814 (CCA, 9, 1948); *Public Service Commission v. Wisconsin Telephone Co.*, 289 US 68, 71; 77 L ed 1036, 1038.

Rule 52 applies to appeals by the Government, and its purpose is to avoid trials *de novo* in the appellate courts (*United States v. Yellow Cab Co.*, 338 US 338; 94 L ed 150); and it applies as well to inferences from undisputed testimony as to determinations of conflicting evidence; *Lowden vs. Hanson*, 134 F 2d 348, 351 (CCA, 8, 1943); *Stout v. Commissioner of Internal Revenue*, 185 F 2d 854 (CA, 6, 1950). It would, therefore, appear that unless the Court of Appeals was adopting the trial court's findings, it should have either dismissed the appeal or remanded the cause, particularly as its own statement of the facts is, in at least one instance, at variance with the record:

"*Opinion* (R 59): "The three children were unmarried and lived with plaintiff. Previous to the gifts, they had taken no active interest in the management of the corporation's affairs. Whether they did so thereafter, does not appear."

Testimony (R. 34-35):

"Q. Take your own son, for instance, Joseph T. Lykes, Jr., to whom you made gifts in 1940, did he follow what you thought he would and become identified with the Company?

A. He has been, since his release from the Navy, actively identified in the business, and has taken increased responsibility, and functioning as I had hoped he would.

Q. Does he also have any official connection with any of the business?

A. He is a Director today of both the parent company and the Steamship Company."

This testimony is on the important point of the non-personal aspect of the gift.

From the record and from the Memorandum Decision of the District Judge (see this brief, pp. 7-8), there appear several bases in the evidence for support of the ultimate fact that the expense in question was properly and proximately related to the management or conservation of income producing property, and not to a merely personal transaction (Internal Revenue Code, Section 24 (a) (1)) including: (1) the non-personal aspects of this particular gift, (2) the arbitrary and capricious act of a government agent as an efficient intervening cause between the gift and the legal expenses, (3) the payment of the legal fees, *not* for the successful conclusion of the gift tax case (which occurred two years later), but at the time of the deficiency assertion, and for relief against the immediate collection of the tax, and (4) the effect of that arbitrary and capricious act on the income producing property given and on that retained. In order to hold as it did, the Court of Appeals must have decided, contrary to the *Bingham* case, that the proximate relationship between the legal expenses and the management or conservation of income producing property is in all cases involving

~~Tax Court. In *Nancy Reynolds Bagley*, 8 TC 130, the~~

gift taxes, a matter of law. The *Bingham* case makes no such exception, and we consider it unwarranted under the statute, the regulations, and the decisions of this Court."

We are not here encumbered with the doctrine of the *Dobson* case (*Dobson v. Commissioner of Internal Revenue*, 320 US 489, 88 L ed 248, 64 S Ct. 239); which was, in any event, substantially legislated out of existence in 1948 (Internal Revenue Code, Section 1141 (a); Section 36, Public Law 773, 80th Congress, 2nd Session). Subtracting that common consideration, it seems apparent that a basic distinction between the *McDonald* case (323 US 57, 64; 89 L ed 68, 74) and the *Bingham* case (325 US 365, 370; 89 L ed 1670, 1675) is that in the former case the Tax Court held *against* the taxpayer, while the decision of the Tax Court in the *Bingham* case was *in favor of* the taxpayer. In the *Bingham* case this Court clearly pointed out that:

(1) questions of reasonableness and proximity are for the trier of facts (325 US at 370; 89 L ed 1675).

(2) questions of law, as applicable to the instant case, involved only the determination of the meaning of "property held for the production of income" as used in the statute (325 US at 371, 89 L ed at 1675).

"The decisive question is whether the property ceased to be held for the production of income because, as the trust term reached its expiry date, the trustees were under a duty to distribute the property among the remaindermen." (325 US at 372; 89 L ed at 1676).

Even with regard to this question, this Court held that it should not "disregard the Tax Court's findings of fact" (325 US at 375; 89 L ed at 1677). Furthermore, this Court held that the distribution of income producing property from the trust there under consideration was consistent with the statutory function of its "management," and approved the Tax Court's determination that:

> "The costs of distribution here were quite as much expenses of a function of 'management' of the trust property as were expenses incurred in producing the trust income; and if 'ordinary and necessary'; they were deductible." (325 US at 375; 89 L ed at 1678)

The Court of Appeals in the instant case limited the application of the *Bingham* case on the theory that it related only to management functions of the trust estate which the trustees were under a *duty* to perform; whereas in the instant case the taxpayer had no *duty* to make the gifts (R 61-62). There is no warrant for that distinction in the statute. If a taxpayer had to prove that each expenditure which he made was the result of a *duty* which he had to perform there would be few allowable deductions under either Section 23 (a) (2) or Section 23 (a) (1).

As a matter of fact, there is no distinction in Section 23 (a) (2) between its application to a trust and to an individual. It is in terms applicable to an individual, and only by virtue of Sections 161 and 162 of the Code is it applicable to a trust (*Mary Lily Bingham Trust*, 2 TC 858; *Bingham's Trust v. Commissioner*, 325 US 365, 368; 89 L ed 1670, 1674). Thus, whatever this Court in the *Bingham* case said of the management of a trust is also true of the management of an individual's

income-producing fund of property, frequently referred to in ordinary parlance as his "estate".

Consequently, when this Court determines that "Section 23 (a) (2) thus treats the trust as an entity for producing income comparable to a business enterprice" (325 US at 374), it also determines that the individual's income-producing "estate" is a comparable entity.

Furthermore, if expenses in connection with the distribution of the trust corpus are deductible as expenses of the management of that income-producing property (325 US at 374, 375), so are expenses in connection with the distribution of the individual's income-producing "estate", regardless of whether he utilizes the mechanism of a trust to that purpose or the simpler mechanism of an *inter vivos* gift.

Under today's tax laws, the distribution of an individual's income-producing property is often a necessary function of his having such property. He can't take it with him; and *inter vivos* transfers are a recognized means of conserving the owner's total property. (For example, pages 136 through 151 of Trachtman's *Estate Planning*, 1949 edition, Practicing Law Institute, discuss *inter vivos* transfers.) The very property which was dealt with in the *Bingham* case was merely the subject matter of the ultimate distribution of an individual's income producing estate. The use of that more cumbersome method of distribution is not a distinction which can logically differentiate it from the instant case.

That "entity" concept of an individual's income producing property has been, in effect, adopted by the Tax Court. In *Nancy Reynolds Bagley*, 8 TC 130, the

taxpayer paid her attorneys a fee of $5000 for services rendered in connection with the "planning and rearrangement of her estate". "Among the changes made were the creation of certain inter *vivos trusts,* with income reserved to petitioner during her life, certain testamentary trusts, the cancellation of insurance policies, and the purchase of new insurance, etc." (at p. 133). She was allowed a deduction under Section 23 (a) (2) of the $5000 fee (at p. 135), despite the fact that many of these activities were merely preliminary to the ultimate result in the instant case, the disposition of income producing property.

We consider, of course, that the case of *Cobb vs. Commissioner,* 173 F 2d 711, was erroneously decided. The court based its decision, in part, on the following determination:

> "We are unable to adopt the impractical concept that giving away property produces income to the donor, or constitutes either management or conservation of the property." (at p. 715)

That, it seems to us, is a matter for the judgment of the taxpayer. A court should not attempt to determine the wisdom, or lack of wisdom, with which an individual manages his income producing property, and to determine whether a deduction occurring as an expense in that management is allowable or not on the basis of whether the taxpayer's management was wise or unwise. No such restriction appears in the statute and the courts have been justifiably reluctant to replace the managing judgment by which an individual holds or disposes of his property with their own.

The instant case is distinguishable from the *Cobb* case—not only on the basis of the different results obtained in the trial courts, but on the facts; and the ad-

ditional facts and circumstances in the instant case are amply sufficient to justify the different result obtained in the trial court. Utilizing the Memorandum Decision of the District Judge and entire record in support of that determination we find that the following considerations were present in this case:

1. The proximate cause of the legal expenses was not the gift, but the attempted assessment of a tax which was so clearly arbitrary and capricious that, in fact, it had nothing to do with the gift on which it was based (this brief, p. 7), and which thus neutralized any "personal" aspect of the gift.

2. The petitioner's (taxpayer's ultimate purpose in following a plan of giving was to further fortify his remaining interest in the company whose stock he gave. This policy proved to be sound (this brief, p. 7-8). It also made the gift non-personal.

3. The payment of counsel fees occurred at the time of the assertion of the gift tax deficiency, and was for the immediate relief of that situation, and not for the *successful* conclusion of the Tax Court case, which occurred two years later (this brief, p. 8).

4. Had the gift tax deficiency been successfully enforced, it would have substantially destroyed the donor's retained holdings in Lykes Brothers, Inc., and would have confiscated most of the property held by him for the production of income (this brief, p. 7).

If we are dealing with "proximate cause" we must also recognize that there may be an efficient intervening cause (Cf. 1 *Shearman and Redfield on Negligence*, page 99, Section 37). We contend that the District Court found one in this case. The arbitrary and capricious assessment put the gift out of the picture and placed the Government in it. The legal expenses were still proximately related, however, to the management, conservation or maintnance of income producing property which had dictated the original gift, or to the retained income-producing property which had to be protected against the assessment. But, assuming the gift was a purely personal transaction, that personal aspect was neutralized by the arbitrary and capricious assessment. The proximate cause of the legal expenses (as distinguished from the proximate relationship between the legal expenses and the management or conservation of property) was no longer a personal transaction—a pure gift—but a fiscal battle between the taxpayer and the tax collector. Certainly no one can contend that litigation with one's Government is a "sport, hobby, or recreation", or otherwise classifiable as a purely personal pursuit. Internal Revenue Code, Section 24 (a) (1); Treasury Regulations 111, Section 29.23 (a) -15 (a), second paragraph. This is a consideration which should militate against classifying any expense of tax litigation as non-deductible (the conclusion of Nahstoll, *Non-trade and Non-business Expense Deductions*, 46 Mich. L. Rev. at 1030-1031); but it is especially cogent in this case.

The second consideration, that concerning the ultimate purpose of the gift, is an adequate answer to the contention of the *Cobb* case that giving is a purely personal pursuit. Giving is not always "impractical". Dis-

positions of property are often made with the idea of ultimately producing additional value in the retained property. To stigmatize all such transactions as impractical is to ignore the multitude of successful businessmen who have adopted one method or another of profit sharing in order to inspire managerial talent. That motive was present in the gift made in this case.

The effect of the gift tax assessment on the taxpayer's retained income producing property is one of degree. In the *Cobb* case the argument over the gift tax involved a relatively minor sum. In the instant case, $145,276.50 was involved (R. 45), a deficiency which, if successfully enforced, would have confiscated most of the taxpayer's (petitioner herein) income-producing estate (R. 46). It was the colossal size of this attack which required the defense, and its expense. It was not a result which a taxpayer might ordinarily have anticipated when making his gift. The Government, on the other hand, must have known, or should have known, that its activities against this taxpayer in 1944 were positive and unwarranted attacks against any income producing properties which he owned; and it should be held to the consequences of that knowledge. It should not be permitted to evade that issue because the excuse which it used to make its attack was a gift—even assuming contrary to fact, that the gift was a purely personal transaction.

CONCLUSION

It follows that the Court of Appeals has decided this case contrary to the applicable statute, Section 23 (a) (2) of the Internal Revenue Code, and in derogation of this Court's decision in *Bingham's Trust vs. Commissioner of Internal Revenue*, 325 US 365, 89 L ed 1670 and other cases cited above; that the Regulations purporting to interpret that Statute, as they were construed by the Court of Appeals, are unauthorized and invalid; and the decision of the District Court was correct.

We, therefore, respectfully pray that the Court affirm the decision of the District Court and reverse the decision of the Court of Appeals.

Respectfully submitted,

CHESTER H. FERGUSON,
GEORGE W. ERICKSEN,
OF MACFARLANE, FERGUSON,
ALLISON & KELLY,
P. O. Box 1531
Tampa, Florida
Attorneys for Petitioner

APPENDIX A

TREASURY REGULATIONS III

Section 29.33 (a)-15.

Nontrade or Nonbusiness Expenses.

(a) In general. Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a) (2) only upon the condition that:

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) It is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter incurred in connection therewith are deductible. Similarly, ordinary and necessary expenses incurred in the management, conservation or maintenance of a building de-

voted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23(a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23(a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitation contained in section 24. Section 24 (a) (5) disallows any amount other-

wise allowable as a deduction (whether under section 23(a) (2) or otherwise) which is allocable to one or more classes of tax-exempt income, other than interest, and has the effect in addition of disallowing a deduction under section 23(a) (2) for amounts otherwise allowable under that section which are allocable to tax-exempt interest. Thus, any amount allocable to the production or collection of one or more classes of income which is not includible in gross income or to the management, conservation, or maintenace of property held for the production of such income is not deductible under section 23(a) (2). Nor does section 23(a) (2) allow any expenses which are disallowed by any of the provisions of chapter 1.

Capital expenditures and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the record of prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

Among expenditures not allowable under section 23(a (2) are the following: Commuters' expenses;

expenses of taking special courses or training; expenses for improving personal appearance; the cost of rental of a safe-deposit box for storing jewelry and other personal effects; and expenses such as expenses in seeking employment or in placing oneself in a position to begin rendering personal services for compensation, campaign expenses of a candidate for public office, bar examination fees and other expenses incurred in securing admission to the bar, and corresponding fees and expenses incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions.

Fees for services of investment counsel, custodian fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under section 23(a)(2) only if (1) they are paid or incurred by the taxpayer for the production or collection of income, or for the management, conservation, or maintenance of investments held by him for the production of income; and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer of such investment.

Ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible even though such property was formerly held by the taxpayer for use as a home.

Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration

expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under this section, notwithstanding that the estate or trust is not engaged in a trade or business, except to the extent that such expenses are allocable to the production or collection of tax-exempt income. But see section 29.162-1 for disallowance of such deductions to an estate where such items are claimed as a deduction under section 812 (b) in computing the net estate subject to the estate tax.

Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring to the ward or minor, or in connection with the management, conservation, or maintenance of property, held for the production of income, belonging to the ward or minor are deductible.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's right's to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible expenses. Expenses paid or incurred by an individual in the determination of liabil-

ity for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income.

The deduction of an item otherwise allowable under section 23 (a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 24 (a) (7). Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

(c) The provisions of section 23 (a) (2) are not intended in any way to disallow expenses which would otherwise be allowable under section 23 (a) (1) or the regulations applicable thereto, or under any other

section of the Internal Revenue Code or the regulations applicable thereto. Double deductions are not permitted. Amounts deducted under one provision of the Code cannot again be deducted under any other provision thereof. (Amended by T.D. 5331, approved Feb. 9, 1944, and by T.D. 5513, approved May 14, 1946.)

LIBRARY
SUPREME COURT, U.S.

Office - Supreme Court, U. S.
FILED
APR 4 1952
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1951

No. 173

JOSEPH T. LYKES,
Petitioner,

vs.

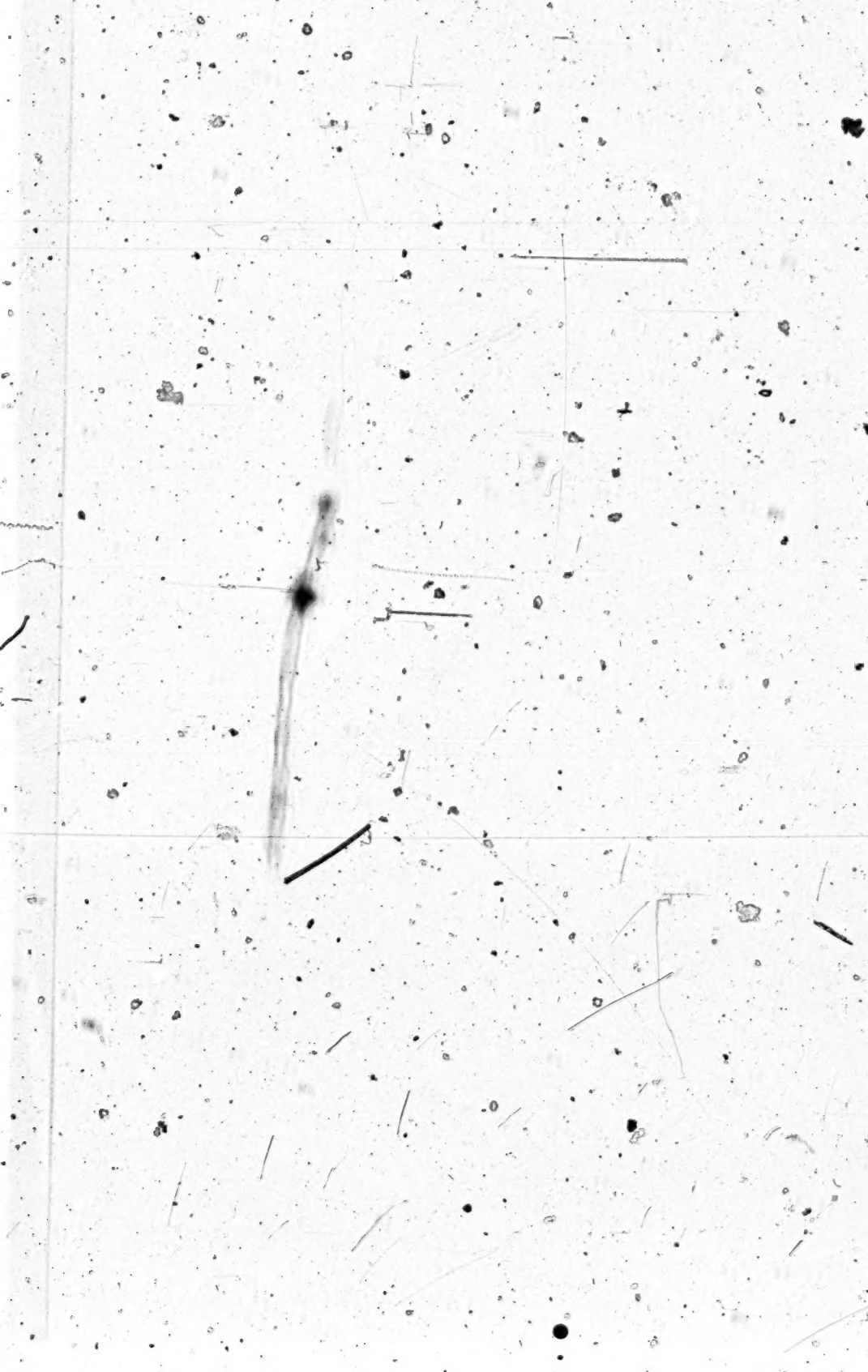
UNITED STATES OF AMERICA,
Respondent.

PETITION FOR REHEARING

CHESTER H. FERGUSON,
GEORGE W. ERICKSEN,
Attorneys for Petitioner

MACFARLANE, FERGUSON,
ALLISON & KELLY,
P. O. Box 1531
Tampa, Florida

Of Counsel:



IN THE

Supreme Court of the United States

OCTOBER TERM, 1951

No. 173

JOSEPH T. LYKES,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR REHEARING

To the Honorable the Justices of the Supreme Court of the United States:

J. T. Lykes, petitioner in this cause, respectfully petitions the Court for re-hearing, and presents the following grounds in support of his petition:

I. *Importance of the case.* This case was set for argument on the summary docket and argued on November 29-30, 1951. The case in its superficial aspects presented only the question of the disallowance or allowance of certain legal fees to this particular petitioner-taxpayer under Internal Revenue Code, Section 23 (a) (2).

Actually the case has an importance far beyond the confines of that limited aspect; and it involves questions of such moment as to compel the most thorough

reconsideration by this Court of its entire attitude toward taxing statutes and administrative rulings of the Internal Revenue Service.

Can taxpayers rely on the obvious and literal meaning of taxing statutes, reasonably construed; or must they be bound by restrictive and antagonistic interpretations of those statutes by the Commissioner?

Never have we had a greater need for a realistic and reasonable interpretation of taxing statutes. Tax rates are drastically high. A taxing theory which does not accept the proposition that Congress intends to tax essentially "net income" can be an instrument for killing the goose (an advised term) which lays the government's golden eggs.

The majority decision in this case appears to accept the proposition that deduction provisions shall be interpreted in their "fair and natural meaning", and not be subject to a restrictive interpretation by this Court (p. 2); and yet that decision permits and applies a restrictive interpretation promulgated by the Commissioner in the Regulations (pp. 8-9).

We do not condone the taxpayer who utilizes the extra-legal remedy of self-help. But denied justice by the tax collecting agencies whose interpretations of taxing statutes have as their principal goal the maximum production of revenue,—and again denied justice in the courts by their tacit approval and application of these unduly restrictive interpretations of taxing statutes, it can be understood how some taxpayers might easily succumb to the transgressions of the influence peddler and the gullible (and probably underpaid) official. The pressure is too great. The stakes are too high. Relief from his Congress is too late to help him.

There is no longer any excuse for this Court to adhere to antiquated theories permitting restrictive interpretations of taxing statutes by the Commissioner. The proper, the realistic, course has been clear for some time. The argument for it is now a matter of compelling public concern.

Under these circumstances this case should receive from this Court the absolute maximum of time that the Court can spare in such additional enlightenment as counsel can offer in re-hearing on the case. Its implications in the administration of the revenue as a whole were, we consider, too important for consideration on the summary docket, and merit the fullest reconsideration by this Court.

II. *The Misapplication of Section 24 (a) (1) of the Code.* The majority opinion (pp. 4-6) determines that litigation with one's government over gift taxes results in personal, living, or family expenses, akin to those incurred in a "sport, recreation or hobby" (Regulations 111, Section 29.23(a)-15(b); H. Rep. No. 2333, 77th Congress, Second Session, 75). Probably several thousands of taxpayers can testify that they don't see the relationship; and the Regulations themselves, under the stress of court decisions, now permit the deduction of legal expenses of *income* tax controversies, regardless of the fact that the generating impulse of the income tax controversy may have been a gift. (Regulations 111, Section 23(a)-15(b)).

The plain fact is, as Mr. Justice Jackson effectively points out in his dissent, that the gift which Mr. Lykes made was not the necessary and effective cause of the gift tax controversy. Obviously we do not contend that

the gift was deductible; nor do we contend that the expense of every controversy between donors and donees over gifts would—absent other facts—necessarily be deductible (majority opinion, p. 3).

We do contend that where the Government, by virtue of an attempt to improperly and illegally swell its revenues, becomes a party to the litigation, the personal aspect ceases.

The absurdity of any other position is demonstrated by another analogy; I work, and I work for a living—therefore, any expenses incurred in connection with my work are personal or living expenses. It was my desire to live that caused the work; and, therefore, none of my expenses incurred toward that end are deductible.

It is admittedly difficult in some cases to distinguish between personal or living expenses and the deductions allowable by Section 23. But it seems clear that wherever the Government attacks a transaction—not because it is a party to it, but for the purpose of making an unwarranted extraction of revenue from it—that attack, and the defense of it, is not a purely personal transaction.

Consequently, the expense of contesting the amount of the gift tax deficiency, was not at all times attributable to the gifts, as such (majority opinion, p. 8). The magnitude of the attack in this case is important because it demonstrates an arbitrary, capricious and unwarranted effort to extract revenues by the Government. It was not a situation which the donor could have reasonably anticipated at the time he made the gifts; and, consequently, it cannot be said to have been proximately caused by the gifts, except under the assumption by this Court that taxpayers must regularly presume

that their Government does act in such an unreasonable manner. If the Court does determine that that is the situation, then truly we are in an administrative wilderness and crying for Congressional relief.

III. *The Commissioner's Regulations are not entitled to substantial weight.* We respectfully submit that this Court, having considered taxation as a practical science, should not resort to stagnant fictions in the law to support mere administrative determinations.

The proposition that Regulations are given some special force and effect by virtue of the fact that the Congress has made many amendments without revising an administrative interpretation (pp. 8-9) is an antediluvian concept of judicial laissez-faire which should be promptly ended. It has lived much too long. It is a fiction on which the Courts ought not rely in order to avoid an obligation which is peculiarly theirs. A fair and reasonable interpretation of taxing statutes is too important a judicial function to be abdicated to the tax gatherer on any such unrealistic basis.

> "[This rule] . . . is an anachronism left over from earlier days in which statutes were briefer, were seldom re-enacted or amended, and administrative interpretation was far simpler. In income tax matters, where statutes now supersede each other at the rate of a new statute at least each two years, with intervening statutes limited to new provisions and amendments, and with the Board of Tax Appeals and numerous District and Circuit Courts issuing conflicting decisions, the policy of administrative interpretation is often based on the principle of expediency. To any student of federal income taxation it is obvious that the ordinary presumption as to congressional familiarity with administrative interpretation is an archaic fiction. Rules of construction are loose and malleable and are often tantalizing obstacles to a reasonable result on the

merits. Such rules should be little more than aids in the determination of tax problems. The attitude of the courts towards the merits of the case should be the real determining factor. Obviously it may not be said in every instance that re-enactment of a statutory provision without change constitutes implied approval of existing administrative practice or that expressed in the regulations promulgated under the prior statute. To suppose that Congress must correct each mistaken construction under the penalty of otherwise incorporating it into the fabric of the statute appears unwarranted. Such a policy would require frequent revisions during years in which administrative interpretation was being put to the test by practice and litigation. Such revisions would inevitably result in a statute so detailed and specific as in turn to lead to further problems of construction.

In complex income tax statutes it is absurd to indulge in the fiction that the full import of the Commissioner's regulations and administrative practice is known to the members of Congress, burdened as they are with the necessity of formulating legislation affecting many other complicated matters. Statutes have been frequently re-enacted without any consideration given to many of the specific sections of the act, the re-enactment being concerned primarily with a revision of a limited number of sections to "close loopholes" and the addition of a few new sections. As the Supreme Court said in the case of *Helvering vs. Hallock:*

> '. . . . we walk on quicksand when we try to find in the absence of corrective legislation a controlling legal principal'."
>
> Mertens, *The Law of Federal Income Taxation*, Volume 1, § 3.24, pp. 97-98.

The pressure for revenue in recent years has led to administrative rulings and determinations designed chiefly to increase the revenues. This petitioner has

suffered from two of them: (1) an unwarranted determination of gift taxes, assumed to be correct until disproved; and (2) a ruling that expenses of litigation of all gift tax controversies, regardless of the surrounding circumstances, are personal expenses and not incurred in the management, conservation or maintenance of the property which he held for the production of income—his individual estate. Through one act he was forced to incur substantial legal expenses to conserve his estate against the government's unwarranted claim; through the other he was denied the right to be taxed on his net income from that estate after deducting the cost of protecting it. Bearing that double cross to this Court, he is told that the Court will construe Section 23(a)(2) in its "fair and natural meaning", but that, nevertheless, a restrictive interpretation of the statute made by his antagonist in the earlier case, will be given "substantial weight" because Congress has the burden of examining minutely every such regulation every time it amends the taxing statutes, a burden which Congress never has undertaken, and which it is impossible, in any practical sense, for it to undertake.

We contend that all taxing statutes should not be only fairly, but liberally, construed in favor of taxpayers under today's conditions, to the end that the *reasons* for the interpretive rules of statutory construction should persist beyond the rules themselves.

> "The basis for the rule (of strict construction) is the same as that supporting a rule of strict construction of positive revenue laws—that the burdens of taxation should be distributed equally and fairly among the members of society."

> ". . . a reasonable construction of all tax measures should be preferred. *Emphasis belongs upon the general objectives of such laws with the view to accomplishing uniformity and equality among the class of persons sought to be taxed.*"
>
> Sutherland, *Statutory Construction*, 3rd ed., §§ 6702, 6703 (emphasis supplies).

According to the rule of the majority opinion, the taxpayer who experiences an income tax controversy arising out of a gift of property has *less* taxable net income than a similarly situated taxpayer who experiences a gift tax controversy; and probably a donee conserving his property from the lien of a gift tax is also more favorably treated. This is not the equality of tax burden which generated the primary rules of statutory construction of taxing statutes.

CONCLUSION

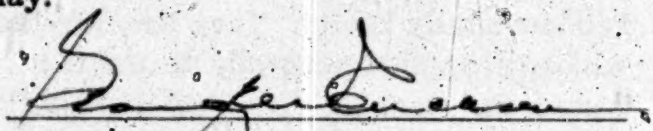
The majority of this Court has based its decision on certain concepts of tax law which we consider are fundamentally faulty. They are, furthermore, concepts which, if applied generally to the law of taxation, will have a far-reaching effect on the administration of the revenues. We respectfully urge the Court to reconsider its decision, and pray the Court to order a re-hearing on the regular docket so that the fullest possible consideration can be given to the implications of the decision in all its aspects. We respectfully pray that the Court, on re-hearing, reverse the Court of Appeals and find for the petitioner, or remand to the District Court for complete findings of fact.

Respectfully submitted,

CHESTER H. FERGUSON,

GEORGE W. ERICKSEN,
of Macfarlane, Ferguson, Allison & Kelly
Attorneys for Petitioner
Address: 215 Madison Street
(P. O. Box 1531)
Tampa, Florida

I, George W. Ericksen, of counsel for J. T. Lykes, petitioner, do hereby certify that the foregoing petition for re-hearing of this cause is presented in good faith and not for delay.



GEORGE W. ERICKSEN,
of counsel
Macfarlane, Ferguson, Allison & Kelly
Attorney for Petitioner.